

Winter 2001

# Japanese Corporate Governance at a Crossroads: Variation in Varieties of Capitalism

Luke Nottage

Follow this and additional works at: <http://scholarship.law.unc.edu/ncilj>

## Recommended Citation

Luke Nottage, *Japanese Corporate Governance at a Crossroads: Variation in Varieties of Capitalism*, 27 N.C. J. INT'L L. & COM. REG. 255 (2001).

Available at: <http://scholarship.law.unc.edu/ncilj/vol27/iss2/2>

This Article is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Journal of International Law and Commercial Regulation by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact [law\\_repository@unc.edu](mailto:law_repository@unc.edu).

---

# Japanese Corporate Governance at a Crossroads: Variation in Varieties of Capitalism

## **Cover Page Footnote**

International Law; Commercial Law; Law

## Japanese Corporate Governance at a Crossroads: Variation in 'Varieties of Capitalism'?

*Luke Nottage*<sup>†</sup>

The numbers coming out of Tokyo do not lie. Unemployment and bankruptcies are at their post-1940s peak. GNP shrank in 1998 . . . [Japan's] government deficit . . . as a percentage of GDP, is among the highest in the OECD. The Tokyo Stock Exchange languished for over a decade . . . Real estate prices have fallen more than 60 percent . . . Most of the nation's banks would be insolvent if Japan followed Western accounting standards . . . if higher interest rates return or the yen does not soon weaken, a range of Japanese manufacturers that have been kept alive since the mid-nineties on the life support of a weak currency and extremely low interest rates will not survive.

. . . .

Yet the sense remains that, irrespective of whatever political difficulties may stand in the way of getting the country moving again, Japan's policy elite doesn't really think things are that bad. . . .

. . . .

Taken together, Tokyo's policy moves paint a portrait of befuddlement, uncertainty, and serious internal rifts. Banking crises are the financial equivalent of fires: one expects alarm, panic, firemen rushing to the scene; what one doesn't expect are groups of obviously capable firemen standing around debating whether there really is or isn't a fire; if there is, should we be using water to put it out, or might we run out of water, so maybe it would be better to try one of those new chemical extinguishers—except that the bill for that would be too high? In the meantime, a whole field of bystanders jumps up and down shouting, 'Put out the bloody fire before it burns our houses too!' So the firemen feel they must look busy but don't really do much.<sup>1</sup>

---

<sup>†</sup> Senior Lecturer, University of Sydney Law Faculty; Barrister of the Supreme Court of New South Wales. B.C.A./LL.B., 1989, Victoria University of Wellington;

## I. Revisiting 'Varieties of Capitalism': Corporate Governance as Stakeholder Contracts

Poor economic performance in the United States during the 1980s led to intriguing attempts to reconceptualize the essential elements of successful capitalism through comparative analysis. Some theorists examined economic achievements and structures in Japan and East Asia, but considerable collaborative research focused more on developments in Europe. One influential strand in the latter research argued that markets were only one institutional mechanism for coordinating economic activity, and that all these mechanisms were shaped by and shapers of "social systems of production (SSPs)," meaning:

[T]he way that the following institutions or structures of a region or structures of a country or a region are integrated into a social configuration: the industrial relations system; the system of training of workers and managers; the internal structure of corporate firms; the structured relationships among firms in the same industry on the one hand, and on the other firms' relationships with their suppliers and customers; the financial markets of a society; the conceptions of fairness and justice held by capital and labor; the structure of the state and its policies; and a society's idiosyncratic customs and traditions as well as its

---

LL.M., 1992, Kyoto University Law Faculty. E-mail [luken@law.usyd.edu.au](mailto:luken@law.usyd.edu.au).

This is an expanded and updated version of a paper originally presented at the annual Kyushu University/Thammasat University conference, "Economic Law Reform in the Aftermath of the Asian Crisis: Experiences of Japan and Thailand," Bangkok, March 20–21, 2000. For help in preparing that paper, I am grateful to my former colleagues at Kyushu University in Japan, Tom Ginsburg and Lorenz Ködderitzsch, and to several generations of LL.M. students who took my class there on "Joint Venturing in Japan" from 1997–99, especially Eric Sibbitt. For subsequent feedback and information, I thank participants at the conference, and a seminar at the University of Victoria, at which I presented a first revised version of the paper on February 14, 2001, as well as David Harvey, Gary Hawke, Jennifer Hill, Jerry Markham, Martin Rhodes, Michael Ryland, and Jonathan Zeitlin. I am also grateful to Christian Joerges for encouraging me to attend his joint seminar, "The Economy as Polity," at the European University Institute (EUI) in Florence, late 2000, which prompted me to explore the literature mentioned in Parts I and V of this article. A longer version of this article appears under the same title as EUI Working Paper in Law No. 2001/8, at <http://www.iue.it/LAW>, and in *THE MULTIPLE WORDS OF JAPANESE LAW: DISJUNCTIONS AND CONJUNCTIONS* 66 (Tom Ginsberg et al. eds., 2001), available at <http://www.capi.uvic.ca>.

<sup>1</sup> R. Taggart Murphy, *Japan's Economic Crisis*, 1 NEW LEFT REV. 25, 27–28, 30 (2000).

norms, moral principles, rules, and recipes for action.<sup>2</sup>

Further, “all these institutions, organizations, and social values tend to cohere with each other, although they vary in the degree to which they are tightly coupled with each other into a full-fledged system.”<sup>3</sup> Accordingly, this new theoretical paradigm tended to stress the likely limits to change in national SSPs.<sup>4</sup> There was particular skepticism about convergence on Anglo-American (especially U.S.) systems centered on markets for standardized goods as primary coordinating mechanisms. Initial restatements acknowledged the limits of this paradigm to explain why such configurations occur within a particular place and time, but they were more ambitious in contending that no particular new configuration would emerge even amidst globalization.<sup>5</sup>

Subsequent research along these lines developed even more ambitious frameworks of analysis to distinguish Anglo-American systems, incorporating a broader array of empirical data. One influential reformulation proposed by Herbert Kitschelt and others adapts David Soskice’s distinction between “liberal market economies” (LMEs) and “coordinated market economies” (CMEs).<sup>6</sup> This turns on whether businesses coordinate their interactions primarily with spot-market contracts, as opposed to “mechanisms of generalized exchange or resource pooling and hierarchical coordination among firms and business associations” allowing employers to produce collective goods.<sup>7</sup> Kitschelt and others acknowledge that considerable differentiation exists among CMEs, but they are most concerned with those European economies primarily coordinated at the national level (notably in Scandinavia) versus the sectoral or industrial level (“Rhine”

---

<sup>2</sup> J. Rogers Hollingsworth & Robert Boyer, *Coordination of Economic Actors and Social Systems of Production*, in CONTEMPORARY CAPITALISM: THE EMBEDDEDNESS OF INSTITUTIONS 1, 2 (J. Rogers Hollingsworth & Robert Boyer eds., 1997) [hereinafter CONTEMPORARY CAPITALISM].

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> See Robert Boyer & J. Rogers Hollingsworth, *From National Embeddedness to Spatial and Institutional Nestedness*, in CONTEMPORARY CAPITALISM, *supra* note 2.

<sup>6</sup> Herbert Kitschelt et al., *Convergence and Divergence in Advanced Capitalist Countries*, in CONTINUITY AND CHANGE IN CONTEMPORARY CAPITALISM 427, 429 (Herbert Kitschelt et al. eds., 1999) [hereinafter CONTINUITY AND CHANGE].

<sup>7</sup> *Id.*

capitalist countries such as Germany or Belgium).<sup>8</sup> Both sub-groups differ from “the Anglo-Saxon world of competitive market capitalism where employers are rarely able to produce collective goods through horizontal or vertical coordination,” a distinction seemingly more important than “mixed cases” such as France and Italy, lying “between LMEs and industry-coordinated CMEs.”<sup>9</sup> Kitschelt and others also follow Soskice in acknowledging a further possible sub-group of CMEs, involving “coordination among groups of companies across industries in Japan and Korea (group coordinated market economies).”<sup>10</sup> However, they pay only limited attention to these countries in their subsequent analysis, and Japan appears as a curious hybrid in later attempts to correlate types of capitalism with political organization, welfare statism, unemployment, and growth rates.<sup>11</sup> Data for Japan does reveal a decline in economic performance since the 1970s, implying that it, too, is being subjected to the major transformations categorizing the other types of capitalist economies analyzed by Kitschelt and others.<sup>12</sup> However, they are not persuaded by the neo-liberal argument of convergence towards minimal political control in allocating resources (or non-market coordination).<sup>13</sup> Instead, they suggest that: (1) nationally coordinated CMEs have moved quite decisively in that direction since the 1980s, but still retain significantly more political control than most sectorally coordinated CMEs; (2) the latter have not moved significantly in that direction, and indeed may exhibit now

---

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at 429 n.3. See also Martin Rhodes & Bastiaan van Apeldoorn, *Capital Unbound? The Transformation of European Corporate Governance*, 5 J. EUR. PUB. POL'Y No. 3, 406, 408–11 (1998). Rhodes and Apeldoorn highlight key differences between “Germanic” and “Latin” economies, characterized as “network-oriented” in terms of institutional context and corporate features (arguably corresponding to CMEs), in contrast to “market-oriented Anglo-Saxon” economies (LMEs). By contrast, the former distinctions are glossed over in Peter Hall & David Soskice, *An Introduction to Varieties of Capitalism* (paper presented to the EUI Seminar on “Economy as Polity: European Theoretical and Historical Perspectives,” October 26, 2000, Florence (revised as an opening chapter in *VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE* (Peter Hall & David Soskice eds., 2001))).

<sup>10</sup> Kitschelt et al., *supra* note 6, at 429 n.3.

<sup>11</sup> *Id.* at 434 tbl.15.1, 435 tbl.15.2, 436 tbl.15.3.

<sup>12</sup> *Id.* at 436 tbl.15.3.

<sup>13</sup> *Id.* at 434–44.

more variety in solutions along this overall parameter; and (3) so do LMEs nowadays, despite notable decreases overall in political control over economic allocation of resources.<sup>14</sup> Reincorporating Japan into this picture as a hybrid implies skepticism about the possibility that it may be moving rapidly towards a LME model. This accords with the earlier express analysis of Japanese developments by Hollingsworth, based on joint research underpinned by the SSP paradigm;<sup>15</sup> and a more recent analysis of the historical roots of capitalist organization in both Germany and Japan.<sup>16</sup>

Another political scientist, Linda Weiss, broadly follows these lines of argument. She contends that many major economies other than Britain and the United States have strong states with actual (or potential) “transformative capacity” for advancing socio-economic welfare, which will survive the onslaught of market forces worldwide.<sup>17</sup> Most prominent examples given are from East Asia, especially Japan, where “governed interdependence” between government and business has arguably developed the richest variety of forms.<sup>18</sup> Generally, she concludes that “nation-states will matter more rather than less,” advancing rather than retarding the development of the world economy, due to “(1) state adaptation rather than decline of functions, (2) strong states as ‘midwives’ not victims of internationalization, and (3) the emergence of ‘catalytic states’ [like Japan] consolidating national and regional networks of trade and investment.”<sup>19</sup>

Importantly, however, all these studies are based primarily on research dating back to the mid-1990s. Subsequently, Japan’s

---

<sup>14</sup> *Id.* at 444 fig.15.2.

<sup>15</sup> J. Rogers Hollingsworth, *Continuities and Changes in Social Systems of Production: The Cases of Japan, Germany and the United States*, in CONTINUITY AND CHANGE, *supra* note 6. Cf. Hollingsworth & Boyer, *supra* note 2, at 3.

<sup>16</sup> Gregory Jackson, The Origins of Non-Liberal Corporate Governance in Germany and Japan (June 10–11, 1999) (paper presented at the European University Institute (EUI) conference, “The Political Economy of Corporate Governance in Europe and Japan”), *reprinted in* THE ORIGINS OF NATIONALLY ORGANIZED CAPITALISM IN GERMANY AND JAPAN (Wolfgang Streeck and Kozo Yamamura eds., forthcoming).

<sup>17</sup> See generally LINDA WEISS, THE MYTH OF THE POWERLESS STATE 41–89 (Peter J. Katzenstein ed., Cornell University Press 1998).

<sup>18</sup> See generally *id.* at 69–79.

<sup>19</sup> *Id.* at 195–96.

full-blown banking crisis in 1997 has been followed by accelerating deregulation and restructuring in financial markets, calling into question the "Japanese model," while the Asian financial crisis has prompted more positive reappraisals of market-driven methods of capitalist organization.<sup>20</sup> Weiss had observed that "a resurgent Japan is not an unlikely outcome of the quiet restructuring and institutional consolidation of the early- to mid-1990s,"<sup>21</sup> but so far there has been little evidence of this. Instead, "regulatory forbearance" (a polite term used by two economists)<sup>22</sup> has characterized Japan's banking crisis, contributing to an enormous fiscal cost as well as probably being largely responsible for the stagnation of the Japanese real economy throughout the 1990s.<sup>23</sup> The stream of bad economic news from Japan, mentioned in the opening quote and showing few signs of abating,<sup>24</sup> further undermines the view of contemporary Japan as a rather exemplary strong state with extensive transformative capacity.

More recently, Weiss has reiterated that: (1) Japan had experienced some growth during Japan's so-called "lost decade" over the 1990s; (2) the Asian crisis may have undermined an incipient recovery; (3) the policy response of Japan's policy-makers, waiting for asset values to increase, may therefore have been rational and certainly appears no better or worse than responses, for instance, to the U.S. savings and loan debacle a decade ago; (4) Japan still retains transformative capacity in the form of links among business and key state actors, including the Ministry of Trade and Industry (MITI, as it was known), which has developed new industrial policy frameworks every decade (recently focusing on information and telecommunications

---

<sup>20</sup> See *id.* at 155.

<sup>21</sup> *Id.*

<sup>22</sup> Akihiro Kanaya & David Woo, *The Japanese Banking Crisis of the 1990's: Sources and Lessons*, IMF WORKING PAPER WP/00/7, 26 (Jan. 2000), at <http://www.imf.org/external/pubind.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>23</sup> *Id.*

<sup>24</sup> Murphy, *supra* note 1, at 2. See, e.g., *Record 3.57 Million Without a Job*, MAINICHI DAILY NEWS, Oct. 30, 2001, at <http://mdn.mainichi.co.jp/news/archive/200110/30/20011030p2a00m0bu015001c.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).



infrastructure); and (5) deregulation was initiated by the Ministry of Finance to encourage Japan's financial sector also to "catch up."<sup>25</sup> However, most commentators stress instead the poorly thought out nature of financial markets deregulation beginning before Japan's big bang, the large scope of its bad loans problem, the likely massive contraction in the size of Japan's banking sector as even more firms move to capital markets financing, and the relatively obvious likelihood of the present banking crisis, yet Japanese policy-makers' comparatively slow response.<sup>26</sup>

On the other hand, there is probably some truth in the following general conclusion from Weiss:

The Japanese model has been sorely tested by recession, low growth and the bank crisis. But in the long run, it may be misguided to hail every change as another nail in the coffin of Japanese capitalism. Indeed, far from Americanizing Japanese capitalism, financial reforms may end up reinvigorating it via creative adaptations of existing institutions.<sup>27</sup>

---

<sup>25</sup> See Linda Weiss, *Developmental States in Transition: Adapting, Dismantling, Innovating, Not 'Normalizing,'* 13 PAC. REV. NO. 1, at 21, 25 (2000). Since a reorganization of central government in effect since January 6, 2001, MITI has become the Ministry of Economy, Trade and Industry (METI). METI provides a list of its e-commerce initiatives on its web site. METI, E-Commerce and E-Government Special Features, at <http://www.meti.go.jp/english/special/E-Commerce/index.html> (last visited Dec. 28, 2001) (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>26</sup> See, e.g., TAKEO HOSHI & ANIL KASHYAP, THE JAPANESE BANKING CRISIS: WHERE DID IT COME FROM AND HOW WILL IT END? (Nat'l Bureau of Econ. Research, Working Paper No. W7250, 1999) (arguing that the deregulation leading up to the Big Bang has played a major role in the current banking problems), available at <http://papers.nber.org/papers/W7250> (on file with the North Carolina Journal of International Law and Commercial Regulation). As one Japanese financial newspaper put it recently, "The nearly unanimous view among experts is that Japan will have to undergo radical surgery to overcome its current crisis, which is not limited to the field of finance, and should be prepared to shed considerable blood." Toyo Keizai, *International Financial Community Gives Japan a Thumbs Down* [*Kokusai Kin'yukai Mo Mihanasu Nippon No Kiki*], JAPAN ECON. UPDATE (Jan. 20, 2001), at <http://www.japanecho.co.jp/jeu/arch/010121.html#t1> (on file with the North Carolina Journal of International Law and Commercial Regulation). One should also not forget Japan's "mini-crisis" with bad housing loans, prior to its full-blown banking crisis in 1997. This was another large financial debacle characterized by moral hazard, regulatory failure, and sharp conflict. Curtis Milhaupt & Geoffrey Miller, *Co-operation, Conflict and Convergence in Japanese Finance: Evidence from the 'Jusen' Problem*, 25 LAW & POL'Y INT'L BUS. 1 (1997).

<sup>27</sup> Weiss, *supra* note 25, at 48-49. See also Masafumi Nakahigashi, *Corporate*

Certainly, we must go beyond breathless reports of radical change emerging from some quarters of the financial press over recent years.<sup>28</sup> The bewildering variety of conclusions reached by other commentators within Japan and abroad, especially in the United States,<sup>29</sup> must also be scrutinized. Key parameters should be identified and quantified to determine whether the transformations in contemporary Japan imply a significant and rapid convergence on Anglo-American forms of capitalist organization. Corporate governance in Japan can offer a central focus in this exercise, because it can be broadly defined to cover most aspects potentially relevant to this determination in a coherent fashion, incorporating readily available recent data. Just as existing institutions may require what Weiss terms "creative adaptations,"<sup>30</sup> so does the construction and application of theory in relation to Japan.

This article therefore begins by arguing that problems of operating corporate bodies can be usefully conceptualized in terms of express or implied "agency" contracts among various stakeholders, especially managers and owner/shareholders, but also creditors, employees, suppliers or contractual partners outside the firm or other owners, and even local residents or government authorities (a type of "social contract").<sup>31</sup> This view does not

---

*Governance in Japan in the 21st Century: A Comment on Nottage, in THE MULTIPLE WORLDS OF JAPANESE LAW: DISJUNCTIONS AND CONJUNCTIONS* 98 (Tom Ginsburg, Luke Nottage & Hiroo Sono eds., 2001), available at <http://www.capi.uvic.ca/publications.html#con>.

<sup>28</sup> See Ronald Dore, *The Corporate Governance Debate in Japan* (June 10–11, 1999) (paper presented at the EUI conference, "The Political Economy of Corporate Governance in Europe and Japan"), revised and reprinted in RONALD DORE, *STOCKMARKET CAPITALISM: WELFARE CAPITALISM: JAPAN AND GERMANY VERSUS THE ANGLO SAXONS* 71 (2000). See also Martin Rhodes & Richard Higgott, *Introduction: Asian Crises and the Myth of Capitalist Convergence*, 13 PAC. REV. No. 1, at 1 (2000).

<sup>29</sup> Simon Reich, *Miraculous or Mired? Contrasting Japanese and American Perspectives on Japan's Economic Problems*, 13 PAC. REV. No. 1, at 163 (2000).

<sup>30</sup> Weiss, *supra* note 17, at 196–97.

<sup>31</sup> See, e.g., W. CARL KESTER, *JAPANESE TAKEOVERS: THE GLOBAL CONTEST FOR CORPORATE CONTROL* (1991) (discussing other expansive views of corporate governance); ROBERT BALLON & KEIKICHI HONDA, *STAKE HOLDING: THE JAPANESE BOTTOM LINE* (2000). However, broad definitions of corporate governance may risk analytical looseness. Kotaro Tsuru, *Japanese Corporate Governance in Transition* (Aug. 2000) (rewritten version of paper presented at the EUI conference, "The Political Economy of Corporate Governance in Europe and Japan," June 10–11, 1999), at <http://>

necessarily entail, as proponents of neo-classical “law and economics” tend to believe,<sup>32</sup> that all such “contracts” should be freed of any mandatory elements.<sup>33</sup> But the approach is useful because it focuses on common problems underlying all these stakeholder relationships. As Takeo Hoshi points out, providing a major organizing framework for this article, a major problem is incomplete information.<sup>34</sup> If all shared full information, for instance, shareholders or creditors would not have to worry about managers wasting their money. Yet in the real world, incomplete information gives rise to the dual problems of “adverse selection” (“hidden information,” resulting for example in creditors agreeing to lend money to what turn out to be generally high-risk firms) and “moral hazard” (“hidden action,” such as managers investing loaned funds into excessively high risk projects).<sup>35</sup> These difficulties are compounded by others: the inability to write contracts for the stakeholder relationships which expressly provide for all possible contingencies, because of the difficulty of foreseeing future scenarios, *and* the inability to perfectly enforce those contracts.<sup>36</sup> These definitions of “adverse selection” and “moral hazard” applied by Hoshi to analyze corporate governance may not accord precisely with their usage initially in the context of insurance markets, but they do highlight underlying problems of opportunism and bounded rationality.<sup>37</sup> They can be usefully developed to uncover and structure empirical data concerning

---

econ.snu.ac.kr/~ecores/activity/00sympo/Kotaro.pdf (on file with the North Carolina Journal of International Law and Commercial Regulation). Cf. John Cioffi, *State of the Art*, 48 AM. J. COMP. L. 501 (2000) (review essay). Readers may judge for themselves the usefulness of the expansive approach adopted in the present article.

<sup>32</sup> E.g., FRANK EASTERBROOK AND DANIEL FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

<sup>33</sup> See *infra* notes 35–40 and accompanying text.

<sup>34</sup> Takeo Hoshi, *Japanese Corporate Governance System*, in *COMPARATIVE CORPORATE GOVERNANCE: STATE OF THE ART AND EMERGING RESEARCH* 847 (Klaus Hopt et al. eds., 1998) [hereinafter *COMPARATIVE CORPORATE GOVERNANCE*].

<sup>35</sup> *Id.*

<sup>36</sup> Enforcement problems have often been highlighted in Japan. Indeed, there are strong statistical correlations between areas where problems exist and activities of criminal organizations. See Curtis Milhaupt & Mark West, *The Dark Side of Private Ordering*, 64 U. CHI. L. REV. 21, 41 (1997).

<sup>37</sup> See OLIVER WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* (1996).

relations involving managers and shareholders,<sup>38</sup> creditors of the firm,<sup>39</sup> and employees.<sup>40</sup> The overall picture is one of significant rapprochement of manager and shareholder interests; severe challenges to post-war bank-financing measures; but less obvious, and perhaps only long term, pressures reshaping employment relations.

Yet raw opportunism may not be the only force at work.<sup>41</sup> Seemingly robust patterns of cooperative relations have developed among firms in some industrial sectors, especially in the automobile industry. They have been most notable in post-war Japan, but they have also found root in the United States.<sup>42</sup> The attraction of the model underlying these patterns, entrenching trust through radically open information gathering and sharing among expanding groups of participants, may encourage the emergence of novel forms of corporate governance, even if the overall trend in Japan nowadays is towards more arm's length relations.<sup>43</sup> Arguably, a key determinant will be whether similar processes of "learning by monitoring" take root also at the level of the Japanese state, another key stakeholder in corporate governance. Adding this contingency further clouds a final assessment of whether Japan will converge on neo-liberal models. But such refinements add new perspectives to the ongoing debate on "varieties of capitalism."<sup>44</sup> In particular, by uncovering possibly conflicting tendencies at different levels of socio-economic and political ordering, they take us beyond views of pervasive transformations and blanket convergence, on the one hand, or little change or persistent differences, on the other.

## II. Shareholders as Primary Stakeholders

The agency problem between shareholders and managers

---

<sup>38</sup> See *infra* Part II.

<sup>39</sup> See *infra* Part III.

<sup>40</sup> See *infra* Part IV.

<sup>41</sup> See *infra* Part V.

<sup>42</sup> Susan Helper et al., *Pragmatic Collaborations: Advancing Knowledge while Controlling Opportunism*, 9 INDUS. AND CORP. CHANGE No. 3, at 443 (2000), available at <http://www.law.columbia.edu/sabel/papers/ICCpragcoll.pdf>.

<sup>43</sup> See *infra* Parts II–IV.

<sup>44</sup> See *infra* Parts V–VI.

usually remains the most important aspect of corporate governance, at least for large publicly held companies.<sup>45</sup> To counter the informational advantage held by managers, two types of systems are available to shareholders. The first is “control oriented.” That is, the shareholders monitor management behavior, often delegating this to a Board of Directors whom they elect; and they intervene if necessary, for example by a proxy vote fight to replace Directors and hence managers. However, the costs involved in this system usually make it more attractive to large shareholders with good management skills themselves. A second system available to shareholders, “arm’s length” control, is more passive. The shareholders do not actively intervene in management. However, they take action when unsatisfied with managers, especially by selling shares, which may lower share prices and encourage hostile takeovers. Employee Share Ownership Programs (ESOPs) can also facilitate such indirect control, by turning employees into another type of stakeholder—shareholders. Another way to motivate managers to work for shareholders is to create common interests, for instance through high-powered incentive methods such as very profit-sensitive bonuses or stock options.<sup>46</sup>

For most of the post-war period in Japan, “arm’s length” control has been weak; but this began to change over the 1990s.<sup>47</sup> On the one hand, stock option schemes were legalized in mid-1997. By January 1999, 165 companies (96 listed) had introduced them,<sup>48</sup> including some of Japan’s largest companies as well as

---

<sup>45</sup> There are about 9,000 such companies in Japan. See generally Hideki Kanda, *Comparative Corporate Governance Country Report: Japan*, in *COMPARATIVE CORPORATE GOVERNANCE*, *supra* note 34 (presenting useful background information about Japanese corporate structure). About 6,330 companies have a capital base sufficient for listing on Japan’s main stock exchanges. See Takashiro Yasui, *Corporate Governance in Japan* (Mar. 3–5, 1999) (paper presented at the OECD conference, “Corporate Governance in Asia: A Comparative Perspective”), at <http://www.oecd.org/pdf/M000015000/M00015752.pdf> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>46</sup> See Hoshi, *supra* note 34, at 851–52; cf. Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 42–64 (2000) (describing a range of other possible conceptions for shareholders’ relations with managers).

<sup>47</sup> See Hoshi, *supra* note 34, at 849, 851–52.

<sup>48</sup> Yasui, *supra* note 45, at 16.

new start-ups (notably in Internet or family-care businesses).<sup>49</sup> In turn, this may begin to affect a longstanding reluctance to remunerate executives of Japanese corporations as highly as their counterparts overseas.<sup>50</sup> Further, bonuses in Japan have been linked to profits generated—in fact, more so (ironically) than dividends paid to shareholders—but not linked closely enough to generate in itself what Hoshi calls a “high powered” incentive for managers to work in shareholders’ interests.<sup>51</sup> However, even the bigger firms nowadays, despite their tradition of “life-time employment” with promotion based primarily on seniority, are beginning to introduce performance-related wage differentials.<sup>52</sup> These transformations in labor relations may also reactivate ESOPs as an incentive for good management. So far in Japan, although ESOPs have been adopted by a large majority of listed companies and collectively amount to significant percentage shareholdings, they have neither encouraged more dividend payouts nor acted as a mechanism to independently control management.<sup>53</sup> Instead, reliance has been placed on “career concerns”—tying reputation to company performance.<sup>54</sup> This is now undermined by economic stagnation.

On the other hand, other types of arm’s length control *have* long operated in Japan, albeit not always so obviously; and they too are becoming increasingly important. Commentators have long stressed the lack of hostile takeovers in post-war Japan, due in large part to the development of extensive cross-shareholdings among firms. The precise historical roots of this tendency remain unclear, although most accounts point to stock market weaknesses soon after World War II, when companies needed capital and the threat of takeovers was high. Ironically, cross-shareholding also

---

<sup>49</sup> *Introduction of Stock Options in Major Firms*, 39 JAPAN LAB. L. BULL. No. 9 (Sept. 1, 2000) (listing examples of corporations offering managerial stock option plans), at <http://www.jil.go.jp/bulletin/year/2000/vol39-09/03.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>50</sup> Yasui, *supra* note 45, at 6.

<sup>51</sup> Hoshi, *supra* note 34, at 852.

<sup>52</sup> See *infra* Part IV.

<sup>53</sup> See Masaru Hayakawa, *Shareholders in Japan: Attitudes, Conduct, Legal Rights, and Their Enforcement*, in JAPAN: ECONOMIC SUCCESS AND LEGAL SYSTEM 237, 243–44 (Harald Baum ed., 1997).

<sup>54</sup> Tsuru, *supra* note 31, at 5.

may have emerged because Japanese corporate law, influenced by U.S. law, further extended substantive rights to shareholders, though many of those rights have remained mandatory.<sup>55</sup> Japanese managers therefore may have encouraged the development of cross-shareholding as an alternative way to protect their interests.<sup>56</sup> Managers in the United States and elsewhere have been able to invoke other techniques more recently, through tailoring their corporate constitutions, such as creating “poison pills” whereby a debenture or the like must be issued if an investor purchases more than a set percentage of shares, or arrangements to limit voting rights to a minority percentage even if the investor obtains more than that percentage of shares.

Whatever the historical origins of the comparative lack of hostile takeovers in post-war Japan, the normative force of this phenomenon has been shaken by recent developments, in the shadow of surging merger activity and tender offers over the 1990s.<sup>57</sup> On January 24, 2000, for example, Shoei Corporation was subjected to a hostile bid from a Japanese firm called M&A Consulting (MAC), led by a former senior official at MITI and financed by Orix Corporation, a large leasing and financial services provider.<sup>58</sup> Although it only obtained 6.5% of the target, in which cross-shareholders controlled two-thirds of outstanding stocks, MAC went on to propose two shareholders’ resolutions and secure proxy votes at Shoei Corporation’s annual general meeting on March 28, 2000, garnering thirty percent support.<sup>59</sup>

---

<sup>55</sup> Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 DEL. J. CORP. L. 189, 210–11 (2000).

<sup>56</sup> See Eiji Takahashi, *Changes in the Japanese Enterprise Groups?*, in JAPAN: ECONOMIC SUCCESS AND LEGAL SYSTEM 227, 229–33 (Harald Baum ed., 1997).

<sup>57</sup> See CURTIS MILHAUPT & MARK WEST, INSTITUTIONAL CHANGE AND M&A IN JAPAN: DIVERSITY THROUGH DEALS 34–36 (Mich. L. and Econ. Res. Paper No. 01-010/Col. L. and Econ. Working Paper No. 193, Nov. 2001), at [http://papers.ssrn.com/paper.taf?abstract\\_id=290744](http://papers.ssrn.com/paper.taf?abstract_id=290744), reprinted in GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS (Curtis Milhaupt ed., forthcoming).

<sup>58</sup> Curtis Milhaupt, *Creative Norm Destruction: The Evolution of Non Legal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2112–14 (2001) (analyzing the history and evolution of norms that have influenced Japanese corporate governance).

<sup>59</sup> See also M&A Consulting, Inc., *Changing Market in Japan: Shareholder Value in Becoming the Japanese Standard*, at <http://www.maconsulting.co.jp/achiev.htm> (last

The emergence of such nonconformist "norm entrepreneurs" is partly a reflection of the changes in Japan over the 1990s. But they build on some less obvious arm's length control mechanisms that remained operative throughout the post-World War II period.<sup>60</sup> So-called "friendly" takeovers or mergers often occurred in the context of poor performance, reflected in weak share prices. Importantly, from the perspective of shareholder/management agency theory, there is strong correlation between share price weakness and resignations of managers.<sup>61</sup> While those taking over firms in hostile bids do not replace managers, the managers retire "voluntarily." Shishido provides one important causal explanation for this pattern: Japanese firms who perform badly on the share market find it difficult to raise equity finance, and that makes it more difficult to obtain debt finance from banks.<sup>62</sup> That pressure will be greater in recessionary times, as it is in Japan nowadays. Conversely, he notes some recent evidence that pressures from the Japanese share market already are forcing some firms to restructure their labor relations, and then signaling satisfaction with that management response in the form of higher share prices.<sup>63</sup> Overall, moreover, aggregate cross-shareholding in publicly traded shares has declined since the stock market collapse and the burst of Japan's "bubble" economy in the early 1990s.<sup>64</sup> Indeed the pace seems to be accelerating: cross-shareholding ratios of around 21% from 1986 to 1995 (money base) declined to 16% in 1998.<sup>65</sup> More declines can be expected. Indeed, there were reports of Japanese corporations winding down cross-shareholdings vigorously in the first quarter of 2000 to improve

---

visited Dec. 28, 2001) (on file with the North Carolina Journal of International Law and Commercial Regulation) (reporting other recent aggressive activities of this entrepreneur).

<sup>60</sup> See Steven N. Kaplan & J. Mark Ramseyer, *Those Japanese Firms with Their Disdain for Shareholders: Another Fable for the Academy*, 74 WASH. U. L.Q. 403 (1996).

<sup>61</sup> *Id.* at 409-17; Tsuru, *supra* note 31, at 6.

<sup>62</sup> Shishido, *supra* note 55, at 216.

<sup>63</sup> *Id.* at 216 n.122.

<sup>64</sup> *Id.* at 233-34.

<sup>65</sup> *Id.* at 232 tbl.6. Data from other sources shows a decline in cross-shareholdings (by value) from 16-18% from 1987-1996 to 15.03% in 1997, 13.22% in 1998, and 10.53% in 1999. See MILHAUPT & WEST, *supra* note 57, at 38-39 tbl.3.



their balance sheets before the end of the fiscal year, taking advantage of a brief revival of the Japanese stock market in 1999.<sup>66</sup>

What life has remained in the stock market over the 1990s has been due in large measure to investment from abroad.<sup>67</sup> Particularly noticeable in recent years is more interest from foreign institutional investors, such as pension and investment funds, whose growing presence in Japan was noted already in the mid-1990s.<sup>68</sup> Although nowadays driven in part by the much bigger boom in the U.S. share market, another key development has been the deregulation of financial markets in Japan in recent years.<sup>69</sup> While these institutional investors may become less prominent in Japan if there is a major downturn in the United States, they surely will remain a significant new feature of Japanese financial markets. As in other countries,<sup>70</sup> they should continue to inject more arm's length control into the corporate governance system in Japan.<sup>71</sup>

One related indication of this is more attention among managers towards efficient use of capital and return on equity. Many companies have provided for share buybacks following amendments to the Commercial Code in 1995 and especially in 1998, although fewer have actually carried out repurchases,<sup>72</sup> and

---

<sup>66</sup> U.S. Embassy Tokyo, *2000 Investment Climate Statement for Japan* (Aug. 3, 2000). Unwinding of cross-shareholdings is also mentioned in U.S. Embassy Tokyo, *2001 Investment Climate Statement for Japan* (July 18, 2001), <http://www.mac.doc.gov/japan/source/menu/investment/jcs01.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>67</sup> By the end of the decade, foreigners held about 10% of listed shares, and 12% of listed Japanese companies have 15% or more foreign ownership. See Yasui, *supra* note 45, at 14.

<sup>68</sup> Hayakawa, *supra* note 53, at 243.

<sup>69</sup> See *infra* Part III.

<sup>70</sup> See, e.g., John C. Coffee, *The Folklore of Investor Capitalism*, 95 MICH. L. REV. 1970 (1997) (reviewing MICHAEL USEEM, *INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE CHANGING THE FACE OF CORPORATE AMERICA* (1996)).

<sup>71</sup> See Mitsuhiro Fukao, *Japanese Financial Instability and Weaknesses in Corporate Governance Structure* (March 3–5, 1999) (paper presented at the OECD conference, "Corporate Governance in Asia: A Comparative Perspective"), at <http://www.oecd.org/pdf/M000015000/M00015809.pdf> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>72</sup> Yasui, *supra* note 45, at 16.

Dore questions whether greater attention from managers to these indices reflects more promotion of shareholder interests or simply faddism.<sup>73</sup> Another aspect is relaxations in December 1997 on the creation of holding companies, seen by Shishido<sup>74</sup> as a possible answer to a set of key problems in Japanese conglomerates so far: accountability and determination of profit centers.<sup>75</sup> These may also be addressed by recent amendments to facilitate corporate reorganizations.<sup>76</sup>

Significant changes in accounting rules for listed companies underpin such developments, expanding possibilities for arm's length control.<sup>77</sup> These have been prompted in part by massive discrepancies in reported financial statements for failed financial institutions, as well as mistrust of internal auditing procedures after a series of well-publicized problems involving corporate racketeers.<sup>78</sup> Consolidated disclosure of contingent liabilities, such as guarantees (common in Japanese corporate finance), took effect in April 1998.<sup>79</sup> The scope of subsidiaries and affiliates, which had to be included in accounts, was expanded the following year. From April 2000, all marketable financial assets held for trading purposes had to be recorded at market price rather than book value; and market value accounting also for cross-shareholdings

---

<sup>73</sup> DORE, *supra* note 28, at 71.

<sup>74</sup> Shishido, *supra* note 55, at 223–24.

<sup>75</sup> Yasui *supra* note 45, at 18.

<sup>76</sup> See generally Masafumi Nakahigashi, *Kigyō Saihen Hōsei no Hensen to Kōgō no Kadai* [Changes in Corporate Reorganization and Future Issues], 35/1–2 CHUKYO HOGAKU [CHUKYO L. REV.] 25 (2000).

<sup>77</sup> See, e.g., Toyo Keizai, *Dawning of the New Accounting Age*, JAPAN ECON. UPDATE (Apr. 22, 2000), <http://www.japanecho.co.jp/jeu/arch/000422.html#t3> (on file with the North Carolina Journal of International Law and Commercial Regulation); Japanese Institute of Certified Public Accountants, Topics, [http://www.jicpa.or.jp/n\\_eng/e-newsflash.html](http://www.jicpa.or.jp/n_eng/e-newsflash.html) (last visited December 28, 2001). Cf. Bernhard Grossfeld, *Global Accounting: Where Internet meets Geography*, 48 AM. J. COMP. L. 261 (2000) (commenting on the centrality of the relationship between accounting rules and corporate governance). There are also major pressures towards convergence created by securities law reforms worldwide, arguably more significant than changes to corporate law rules. See, e.g., John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U. L. REV. 641 (1999).

<sup>78</sup> Yasui, *supra* note 45, at 13.

<sup>79</sup> *Id.* at 17 n.18.

and long-term securities holdings was required from April 2001.<sup>80</sup> From April 2000, or (optionally) 2001, listed companies also had to disclose unfunded pension liabilities by valuing pension assets and liabilities at market price.<sup>81</sup> This already has highlighted further difficulties in some of Japan's largest firms,<sup>82</sup> and all these changes make evaluation of shareholdings more transparent and objective.

In parallel, potentially important developments have started to transform "control-oriented" shareholder mechanisms. The "main bank" system has been central in this regard for most of the post World War II period. It involved a bank—usually with the largest shareholding, albeit limited under the Anti-Monopoly Law (AML) to five percent or less—sending its own managers to direct operations of debtor companies performing too badly.<sup>83</sup> The system is coming under pressure also due to the recession, particularly as it has affected Japanese financial institutions, combined with deregulation of the financial sector.<sup>84</sup>

By contrast, smaller or less powerful shareholders in Japanese companies have faced a major obstacle in exercising more direct control over managers: the emasculation of the board of directors, due to the tradition of appointing directors from among managers, usually resulting in very large boards.<sup>85</sup> This too has been related to patterns of life-long employment in (at least top-tier) Japanese companies. Combined with *keiretsu* and other links within groups of companies,<sup>86</sup> this tradition also has tended to make the

---

<sup>80</sup> *Id.* at 17 n.19.

<sup>81</sup> U.S. Embassy Tokyo, 2001 *Investment Climate Statement for Japan*, para. 16 (July 18, 2001), <http://mac.doc.gov/japan/source/menu/investment/jcs01.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>82</sup> See, e.g., Toyo Keizai, *What Will Ghosn Do About Nissan's 400 Billion Yen Pension Debt?*, JAPAN ECON. UPDATE (Apr. 22, 2000), <http://www.japanecho.co.jp/jew/arch/000422.html#t4> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>83</sup> See discussion *infra* Part III.

<sup>84</sup> See discussion *infra* Part III.

<sup>85</sup> Yasui, *supra* note 45, at 4–5. As of July 1998, the average number of directors at listed companies was about twenty; in addition, forty-nine companies had forty directors or more. *Id.* at 5.

<sup>86</sup> In a typically provocative paper, Miwa and Ramseyer contend that main-bank or horizontal *keiretsu* are no more than a myth concocted first by Marxist economists in Japan in the 1960s. YOSHIRO MIWA & J. MARK RAMSEYER, *THE FABLE OF THE KEIRETSU*

"statutory auditor" scheme largely ineffective in monitoring management.<sup>87</sup>

This cozy system is now challenged by more appointments of outside directors. Boards are also being downsized to promote more effective decision making. An early example was Sony, always an innovator, and now with particularly high foreign ownership.<sup>88</sup> But of the two-thirds of listed companies that responded to a survey in September 1998, thirty percent had appointed outside directors and reduced the size of the board.<sup>89</sup> By May 1999, about half of the seventeen major banks had introduced executive officers (instead of directors) and downsized their boards.<sup>90</sup> Lateral pressure has come from the Corporate Governance Forum, established in 1994 by a former president of the Industrial Bank of Japan (now merged into the Mizuho group) and now co-led by Orix Corporation chairman, Yoshihiko

---

1 (John M. Olin Discussion Paper Series No. 316, Mar. 2001) (paper presented at the University of Michigan conference, "Change, Continuity, and Context: Japanese Law in the Twenty-first Century," Apr. 6-7, 2001), [http://www.law.harvard.edu/programs/olin\\_center/papers/pdf/316.pdf](http://www.law.harvard.edu/programs/olin_center/papers/pdf/316.pdf) (on file with the North Carolina Journal of International Law and Commercial Regulation), *reprinted in* 27 LAW & SOC. INQUIRY (forthcoming). However, while presenting some econometric data suggesting that financial links cementing firms in such corporate groupings are not significant, they do not count personnel relations and exchanges among group firms, seen as important by other commentators on *keiretsu*. This point was made by Professor Yoichi Hamada following their conference presentation, and is now picked up by Curtis Milhaupt. CURTIS MILHAUPT, ON THE (FLEETING) EXISTENCE OF THE MAIN BANK SYSTEM AND OTHER JAPANESE ECONOMIC INSTITUTIONS (Col. L. and Econ. Working Paper No. 1949, Nov. 2001), at [http://papers.ssrn.com/paper.taf?abstract\\_id=290283](http://papers.ssrn.com/paper.taf?abstract_id=290283), *reprinted in* 27 LAW & SOC. INQUIRY (forthcoming). Milhaupt also presents several other compelling criticisms of the analysis, and over-exaggerations, contained in the paper by Miwa and Ramseyer.

<sup>87</sup> Yasui, *supra* note 45, at 5-6.

<sup>88</sup> RONALD DORE, STOCK MARKET CAPITALISM: WELFARE CAPITALISM: JAPAN AND GERMANY VERSUS THE ANGLO-SAXONS 104, 116-19 (2000); Sumio Sano, Corporate Governance at Sony: Innovations in the Board of Directors 4-5 (Apr. 4, 2001) (paper presented at the third OECD Asian Roundtable to Discuss Corporate Governance), <http://www.oecd.org/pdf/M00009000/M00009075.pdf> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>89</sup> Tokyo Stock Exchange, TSE Efforts to Encourage Thorough Corporate Governance by Listed Companies in Japan 3 (May 2000) (paper presented at the second OECD Asian Roundtable on Corporate Governance, May 31-June 2, 2000, Hong Kong), <http://www.oecd.org/pdf/M000015000/M00015766.pdf> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>90</sup> Yasui, *supra* note 45, at 20.

Miyauchi. The Forum published Principles of Corporate Governance in 1998,<sup>91</sup> calling for corporate governance rules reforms similar to those espoused by the OECD and the California Public Employees Retirement System (CALPers). Also important are direct pressures from institutional investors, especially from those based abroad like CALPers. Further, as foreign direct investment in Japanese companies grows,<sup>92</sup> outside directors should become more common. So far the most salient examples of outside appointments to the boards of Japanese companies have been from large foreign investors in very weak companies.<sup>93</sup> These have mainly been as *managing* directors, rather than non-executive directors theoretically better able to monitor for shareholder interests. Yet, as outsiders, this tendency disrupts the traditional board structure in Japanese corporate governance. Even some insiders are becoming less predictable, with a number of prominent presidents having reached their position through career paths outside the mainstream within their companies, including lengthy periods abroad.<sup>94</sup> They have taken initiatives in

---

<sup>91</sup> MICHAEL GIBSON, 'BIG BANG' DEREGULATION AND JAPANESE CORPORATE GOVERNANCE: A SURVEY OF THE ISSUES 14 (Board of Governors of the Federal Reserve System, International Finance Discussion Papers, No. 624, Sept. 1998), <http://www.federalreserve.gov/pubs/ifdp/1998/624/ifdp624.pdf> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>92</sup> Ludwig Bonacker, *Unternehmenskauf in Japan*, 8 ZEITSCHRIFT FÜR JAPANISCHES RECHT 114 (1999), available at <http://www.djjv.org/japrecht/heft8/vortraege/bonacker.html>; Luke Nottage, *Investing in Japan Today*, 49 Asiawatch (CCH) 16 (2001).

<sup>93</sup> One example is Renault in Nissan. See *Nissan's Restructuring Plan and the Union's Response*, 39 JAPAN LAB. L. BULL. No. 1 (Jan. 1, 2000), <http://www.jil.go.jp/bulletin/year/2000/vol39-01/03.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation); *Putting Nissan Back on Track*, 27 JAPAN ECHO, No. 2, 36, 36-40 (Apr. 2000) (interview by Kishi Nobuhito with Carlos Ghosn, COO, Nissan Motors Co.), available at <http://www.japanecho.co.jp/docs/html/270211.html>. Another example is DaimlerChrysler in scandal-stricken Mitsubishi Motors. See Luke Nottage, *New Concerns and Challenges for Product Safety in Japan*, 11 AUSTL. PRODUCT LIABILITY REP. No. 8, 101, 101-11 (2000), <http://www.iue.it/LAW/res/nottage/aplrproofs.pdf> (on file with the North Carolina Journal of International Law and Commercial Regulation). See also *Merging Japan*, OECD OBSERVER (Feb. 24, 2000) (discussing cross-border mergers and acquisitions, particularly those involving Japanese automotive companies), <http://www.oecdobserver.org/news/fullstory.php/aid/198> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>94</sup> See Tsuru, *supra* note 31, at 15.

increasing truly independent statutory auditors, promoting disclosure, and so on. All these developments help explain why a Study Group sponsored by MITI, regulating and supporting most areas of industry in Japan, has proposed significant reforms to Japanese corporate law by 2002, including more outside directors and other measures to separate management from monitors of corporate activities.<sup>95</sup>

Involving outside directors, and heightened attention generally to shareholder rights in the 1990s,<sup>96</sup> are trends related to a strengthening of the ability of all shareholders—including minority shareholders—to enforce their rights. Especially in shareholder derivative litigation, the key seems to have been a legislative amendment in 1993 which set filing fees at a uniform 8,200 yen (less than U.S. \$100). There were only 84 derivative action cases pending in Japanese district and high courts in 1993; but this jumped to 133 in 1994 and to 158 in 1995.<sup>97</sup> In 1997, there were 219 derivative suits pending before district and high

---

<sup>95</sup> One of the largest pension funds in the world, CALPers, increased significantly its investments outside the United States in the mid-1990s, calling for improvements in corporate governance in countries like Japan in which it increased exposure. CALPERS, *Corporate Governance Facts* (Dec. 2001), at <http://www.calpers.ca.gov/about/factglan/corpgov/corpgov.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation). It has since teamed up with the large UK fund, Hermes (<http://www.hermes.co.uk>), to advance such causes. However, appointing outside directors is not only a foreign concern. "According to a survey by [Japan's] Life Insurance Association, 42 percent of companies and 84 percent of institutional investors [in Japan] suggested that outside directors would stimulate the debate, add new perspectives, and strengthen monitoring." Nicholas Benes, *Finally, Corporate Japan Begins to Shift into Reform Gear*, ASIAN WALL STREET J., Jan. 8–14, 2001, at 16. More generally, Japanese institutional investors recently "were urged by the Employee's Pension Fund Association, the effective leader of [Japan's] corporate pension sector, to exercise [voting rights at shareholders' meetings] to the advantage of pensioners," when U.S. consulting firm Institutional Shareholders Services entered the Japanese market in April 2001 aiming to show them how to best do so. *Japanese Shareholders to be Schooled in How to Exercise Voting Rights*, NIKKEI WKLY., Feb. 12, 2001, at 12.

<sup>96</sup> Toshimitsu Kitagawa & Luke Nottage, *Globalization of Japanese Corporations and the Development of Corporate Legal Departments: Problems and Prospects* (Dec. 11–14, 1998) (paper presented at the Harvard Law School conference, "The Emergence of an Indigenous Legal Profession in the Pacific Basin").

<sup>97</sup> MARK D. WEST, *WHY SHAREHOLDERS SUE: THE EVIDENCE FROM JAPAN* 9 tbl. 1 (John M. Olin Center for Law and Econ., Working Paper No. 00-0010, 2000), <http://papers.ssrn.com> (on file with the North Carolina Journal of International Law and Commercial Regulation).

courts,<sup>98</sup> and 286 pending by the end of 1999.<sup>99</sup> By 1998, half of listed companies had taken out insurance covering directors against certain claims.<sup>100</sup> This procedural change thus has significantly reinforced the comparatively strong substantive rights of shareholders under Japanese law.<sup>101</sup> Further, in late 2000 the Osaka District Court awarded a record 83 billion yen in damages against eleven former directors of Daiwa Bank, in a shareholders' suit based on poor supervision resulting in illegal bond trading by the bank's New York office.<sup>102</sup> The collapse of the Sogo department store chain resulted in another massive claim against its founding president in 2001; and on March 12, a lawyer belonging to the "Kabunushi Ombudsman" watchdog group filed suit against eleven former and current directors of Mitsubishi Motors Corporation for 1.17 billion yen, demanding they take responsibility for 1.5 billion yen in lost vehicle sales resulting from concealing defect claims.<sup>103</sup> These events have prompted business interests to call for amendments to the Commercial Code to restrict liability exposure of managers, although strong opposition has been voiced.<sup>104</sup> By expanding the capacity of all shareholders to directly or indirectly control managers, burgeoning shareholder derivative litigation makes it more difficult for key shareholders (such as main banks) to act in their own interests (or for creditors generally) to the detriment of shareholders overall.<sup>105</sup> Thus, "control-oriented" supervision of managers by main banks

---

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> DORE, *supra* note 88, at 96.

<sup>101</sup> Shiro Kawashima & Susumu Sakurai, *Shareholder Derivative Litigation in Japan: Law, Practice, and Suggested Reforms*, 33 STAN. J. INT'L L. 9, 10, 18–21 (1997).

<sup>102</sup> Milhaupt, *supra* note 58, at 2115.

<sup>103</sup> *Shareholders Group Sues MMC Over Cover-Up*, MAINICHI DAILY NEWS, Mar. 13, 2001, at <http://www12.mainichi.co.jp/news/mdn/search-news/837117/MMC-04.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>104</sup> *Id.* Cf. Government Plans Damages Limit for Company Bigwigs, MAINICHI DAILY NEWS, Nov. 24, 2001, at <http://www12.mainichi.co.jp/news/mdn/search-news/839445/daiwa-0-1.html> (on file with the North Carolina Journal of International Law and Commercial Regulation). On the background to the reform discussion, see West, *supra* note 97, at 10 n.20.

<sup>105</sup> Yasui, *supra* note 45, at 10.

is further displaced by actual or potential supervision through shareholders more generally.

### III. Creditors, Recession, and Financial Market Deregulation

A distinctive feature of post-war corporate governance in Japan has been the greater importance of creditors as stakeholders, due to comparatively more use of bank finances as opposed to equity finance. Yet this characteristic has been fading over the last two decades, as companies accumulated retained earnings and gradual financial markets deregulation permitted them to more readily raise funds through bond issues and the like.<sup>106</sup> Already in mid-1997, before the banking crisis, a survey of managers found that sixty percent expected the role of main banks to decline.<sup>107</sup> The relative importance of capital markets in corporate finance will undoubtedly expand in importance in the wake of ongoing economic stagnation and Japan's current severe credit crunch, combined with globalization and broader financial market deregulation. The latter program was initiated at the end of 1996 and accelerated in 1998, because of concerns about poor return on capital by Japanese financial institutions throughout the post World War II period, and especially about a rapid loss of global competitiveness in the 1990s.<sup>108</sup> This "Big Bang" (or "Long Bang"! ) is now virtually complete, and the legislative and structural reforms are very wide-ranging.<sup>109</sup>

---

<sup>106</sup> See generally TAKEO HOSHI ET AL., CORPORATE FINANCING AND GOVERNANCE IN JAPAN (2001).

<sup>107</sup> Yasui, *supra* note 45, at 12.

<sup>108</sup> See generally James Malcolm, *Making Sense of the Japanese "Big Bang,"* 1 ICCLP REV., Sept. 1998, at 47 (reviewing the translation of the "Big Bang" from proposal to policy), available at <http://www.j.u-tokyo.ac.jp/~icclp/Review1-2.pdf>.

<sup>109</sup> Ministry of Finance, Schedule for Financial System Reform (Apr. 2000), at <http://www.mof.go.jp/english/big-bang/ebb33.pdf> (on file with the North Carolina Journal of International Law and Commercial Regulation). See also Eric C. Sibbitt, *A Brave New World for M & A of Financial Institutions in Japan*, 19 U. PENN. J. INT'L & ECON. L. 965, 1025 (1998); Hideki Kanda, *New Aspects of Japanese Financial Regulation* (Nov. 4-5, 1999) (paper presented at the fourth Sho Sato Conference, "Legal Reform and Social Change in Japan") (on file with the North Carolina Journal of International Law and Commercial Regulation). See also Kenjiro Egarashi, *Transformation of the Financial System and the Corporate Law of Japan* (Aug. 12, 1999) (paper presented at the University of Melbourne conference, "Legal Crisis in Japan and Asia"); Malcolm, *supra* note 108, at 48.



As mentioned in Part I,<sup>110</sup> like other stakeholder relationships, the relationship between creditors and managers gives rise to problems of adverse selection (leading to credit going too readily to risky firms) and of moral hazard (monitoring problems allowing poor projects by management). Blame for the abrupt decline in the Japanese financial sector over the 1990s lies in part with the Japanese government, particularly the Ministry of Finance (the Bank of Japan having become a more independent policy maker only relatively recently). Yet Japanese financial institutions were also responsible for their own plight, having embarked on a huge spending spree in the late 1980s, which has led to reports of massive bad debts in recent years.<sup>111</sup> Generally, this disaster stems from distortions in evaluating and pricing risk.<sup>112</sup> Specifically, it relates to problems in corporate governance, which encouraged financial institutions in Japan to lend (and invest) in risky firms, and then not adequately monitor managers in those firms.<sup>113</sup>

One solution for these tensions between creditors and managers is to give creditors shares in the companies to which they lend. This helps to the extent that shareholders generally can overcome agency problems vis à vis managers.<sup>114</sup> In addition, creditors can attempt to control managers in two main ways. One, again, is more arm's length control. The creditor still delegates much control to managers, but may step in to force bankruptcy, thus creating an incentive for managers to pursue creditors' interests.<sup>115</sup> However, forcing bankruptcy must be a credible option, and Japanese insolvency law has had various problems, which only began to be addressed seriously towards the end of the

---

<sup>110</sup> See *supra* Part I.

<sup>111</sup> Beate Reszat, *Finanzkrise in Japan [Financial Crises in Japan]*, 8 ZEITSCHRIFT FUER JAPANISCHES RECHT 106 (1999), available at <http://www.djjv.org/japrecht/heft8/vortraege/reszat.html>.

<sup>112</sup> See The 21st Century Public Policy Institute, A Prescription for Normalizing the Function of the Financial System (June 30, 1999), at <http://www.21ppi.org/english/policy/19990630/summary2.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>113</sup> See generally PAUL DICKIE, STRENGTHENING EAST ASIAN FINANCIAL SYSTEMS: AN INTEGRATED APPROACH 10 (Asian Studies Institute Working Paper, Victoria University of Wellington, 1999); Kanaya & Woo, *supra* note 22, at 22.

<sup>114</sup> See *supra* Part II.

<sup>115</sup> Hoshi, *supra* note 34, at 853.

1990s.<sup>116</sup> One result has been enactment of a more functional corporate reorganization regime in 1999, generating 392 proceedings within the first six months of coming into force on April 1, 2001.<sup>117</sup>

Alternatively, or in addition, creditors can adopt more control-oriented strategies. They can monitor more directly the behavior of managers, and intervene if necessary in their appointment or replacement. One way in which Japanese banks have been able to directly monitor their lenders' managers, at least within Japan, has been by providing a range of services (such as general business advice or match-making) rather than just loans.<sup>118</sup> Yet that was difficult in overseas lending; and difficulties were encountered domestically as Japanese companies themselves became more sophisticated and competition intensified as a result of accelerating financial markets deregulation.<sup>119</sup> The latter, combined with the recessionary environment facing Japanese financial institutions in particular, also makes it more difficult to retain the long-term relationship required of a firm's main bank.<sup>120</sup> A key aspect of the main bank's role was to act as a primary lender, which also held shares over lengthy periods, and intervened especially in times of the debtor's financial distress by seconding bank managers.<sup>121</sup> As banks become strapped for funds, however, they may call in their loans or simply refuse to lend more; an increase in lender liability claims by debtors was noted in the mid-1990s.<sup>122</sup> More recently, other cases have been reported in which main banks did not save companies by providing loans, while in other instances they did

---

<sup>116</sup> See generally Kent Anderson, *The Cross Border Insolvency Paradigm: A Defense of the Modified Universal Approach Considering the Japanese Experience*, 21 U. PENN. J. INT'L & ECON. L. 679, 700-24 (2000) (using Japan as a case-study in dealing with cross-border insolvencies).

<sup>117</sup> Andreas Kaiser, *New Japanese Bankruptcy to Rehabilitate Indebted Business*, LEGAPRACTICE (Jan. 2001), at [http://www.legamedia.net/legappractice/kaiser\\_andreas/2001/01-01/0101\\_kaiser\\_andreas\\_bankruptcy.php](http://www.legamedia.net/legappractice/kaiser_andreas/2001/01-01/0101_kaiser_andreas_bankruptcy.php) (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>118</sup> Yasui, *supra* note 45, at 10.

<sup>119</sup> *Id.* at 12.

<sup>120</sup> *Id.* at 12-13.

<sup>121</sup> *Id.* at 9.

<sup>122</sup> Curtis Milhaupt, *A Relational Theory of Japanese Corporate Governance: Contract, Culture, and the Rule of Law*, 37 HARV. INT'L L.J. 3, 49-55 (1996).

not bear a disproportionate burden of losses following liquidation. A related phenomenon is a belated “flight to quality” in lending, perversely exacerbating the present credit crunch. Finally, there is evidence of banks selling off their shareholdings, reportedly after client firms offloaded their stocks in banks, and in the shadow of dangerous declines in the ratio of market over book value (4:1 in 1986, but only just over 1:1 in 1998).<sup>123</sup> Unwinding shareholdings prevents financial institutions from remaining or developing into a main bank, but does allow them to monitor debtor firms, and creates less incentive to send their own managers to debtor firms if in distress (especially as even the big banks have enough problems of their own nowadays). Reputation as a main bank can unravel quickly, and it is difficult to regain.<sup>124</sup>

Such breakdowns have become even more likely as more foreign financial institutions have taken advantage of deregulation to enter the Japanese market since the late 1990s.<sup>125</sup> These outsiders are particularly likely not to take over—and certainly not take on—even small shareholdings in debtor firms in such a volatile environment. Even if they do, they may refuse to “take turns,” accepting instead the delegation of other creditors/shareholders to send valuable management resources to help keep debtor firms alive. Their inclination, no doubt often in their short-term interest, may be to enforce their strict legal rights by calling in their security or forcing bankruptcy. After all, lending institutions and associations in Japan have long made sure that their strict rights are well protected by standard general terms and conditions for banking transactions.<sup>126</sup>

Three other factors now undermine the main bank system. The first arises from the nationalization and re-privatization of the failed Long-Term Credit Bank.<sup>127</sup> The government sold it to a group of foreign investors, including Citigroup, giving a “put option” to return any assets (loans) that decline from book value

---

<sup>123</sup> Fukao, *supra* note 71, at 6–8.

<sup>124</sup> Tsuru, *supra* note 31, at 8.

<sup>125</sup> See generally Sibbitt, *supra* note 109.

<sup>126</sup> See Masabumi Yamane, *Financial Transactions in Japanese Law*, in JAPANESE BANKING, SECURITIES AND ANTI-MONOPOLY LAW 21, 23–29 (Hiroshi Oda & R. Geoffrey Grice eds., 1994).

<sup>127</sup> Milhaupt, *supra* note 58, at 2110–11.

(as of March 1, 2000) by twenty percent or more within three years.<sup>128</sup> But this is lost if the bank accepts a borrower's request for loan forgiveness. In mid-2000, the re-privatized bank refused to forgive debts owed by Sogo Department Store, forcing it into bankruptcy, going against what has been expected of a main bank.<sup>129</sup> More generally, bank failures undercut an implicit guarantee against the one given by the Japanese government, in exchange for strong institutions supporting weak ones through the main bank system.<sup>130</sup> Finally, the Asian financial crisis and Japan's long recession are perceived to have caused a significant shift in beliefs about the benefits of bank-oriented corporate finance and governance.<sup>131</sup>

Theoretically, there is some possibility of Japanese financial institutions instead starting to accumulate larger shareholdings in debtor firms, hence positioning themselves for *more* control-oriented monitoring of debtor firms. This could follow from an amendment to Article 11 of the AML, as clarified by Japan Fair Trade Commission Guidelines, whereby a financial institution can hold more than five percent of shares issued by a company, if the latter's business was subordinated to the former's, "at least 50 percent, in principle." Previously, this was allowed only if the latter's business was subordinate to the former's, "at least 90 percent, in principle."<sup>132</sup> As more and more firms are permitted to add financial services to their operations, this route may lead to banks being able to take greater shareholdings in them. Yet this option still does not remain open for investments in companies whose main business is not related to financial services, even in the new broad sense. In addition, as the economic recession and problems in the financial sector persist, it seems unlikely that financial institutions in Japan will want to try to invest broadly like this. Rather, we can expect more sell-offs in the small shareholdings held so far, and consequent ongoing decline in the main bank system as a key corporate governance mechanism in

---

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> See generally Milhaupt & Miller, *supra* note 26.

<sup>131</sup> Milhaupt, *supra* note 58, at 2110–11.

<sup>132</sup> Cf. Sibbitt, *supra* note 109.

Japan, although it may remain important for smaller firms.<sup>133</sup>

Domestic institutional investors, whose buffers of unrealized gains in land and shares have also been sharply eroded, will find it difficult to take up this slack, at least on the basis of implicitly assuming disproportionate risks through such buffers. This reinforces pressures to (1) allow defined contribution pension plans in order to attract foreign investment,<sup>134</sup> (2) restore faith in investment trust management in order to encourage more individual investment on the Japanese share market, (3) improve disclosure and accountancy rules in order to promote further investment from abroad, and (4) further encourage share buybacks.<sup>135</sup>

#### IV. Employees and the Vicissitudes of the Labor Market

Another often cited aspect of Japanese corporate governance, especially into the 1980s, is the strong influence of employees.<sup>136</sup> The conventional wisdom has been that Japanese corporate governance was profoundly influenced by the orientation of companies first towards “people” (i.e., employees), then “products” (i.e., technically excellent goods), and then “profits” (for shareholders).<sup>137</sup> This is contrasted with the German model (fixated first on products, then people, and then profits), and especially the Anglo-American model (first profits, then products,

---

<sup>133</sup> Cf. Carla Koen, The Japanese “Main Bank” Model: Evidence of the Pressures for Change (June 23–24, 2000) (paper presented at the first annual Conference of the Research Network on Corporate Governance), at <http://www.wz-berlin.de/wb/cogonetpdf/koen.en.pdf> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>134</sup> Broader based reform of the state pension scheme also seems important, since this underscored the shift in corporate governance in the United States and dampened changes in Germany. Cf. Mary O’Sullivan, *Corporate Governance and Globalization*, 570 ANNALS AM. ACAD. POL. & SOC. SCI. 153 (2000).

<sup>135</sup> See generally Fukao, *supra* note 71.

<sup>136</sup> See, e.g., Yoshiro Miwa, *The Economics of Corporate Governance in Japan*, in COMPARATIVE CORPORATE GOVERNANCE, *supra* note 34; Ryuichi Yamakawa, *The Silence of Stockholders: Japanese Labor Law from the Viewpoint of Corporate Governance*, 38 JAPAN LAB. L. BULL. No. 11 (Nov. 1, 1999), at <http://www.jil.go.jp/bulletin/year/1999/vol38-11/04.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>137</sup> See Yamakawa, *supra* note 136.

people last!).<sup>138</sup> The importance of employees in Japanese companies, at least “regular” employees in larger ones, has admittedly been strong.<sup>139</sup> Yet this factor can also be analyzed in terms of agency problems, and how their stakeholding in companies relates to that of other stakeholders. That analysis, together with observed tendencies in the labor market and important legislative amendments, points to further growing pressures on Japanese corporate governance.<sup>140</sup>

Usually, discussions of relations between employees and managers center on the latter as “principals,” attempting to hire the former as “agents,” despite the possibility of adverse selection, and attempting to monitor their delegated activities, despite moral hazard (“shirking,” due again to imperfect information in the

---

<sup>138</sup> Jean-Pierre Lehmann, *Corporate Governance in East Asia and Western Europe: Competition, Confrontation and Co-Operation*, in COMPARATIVE CORPORATE GOVERNANCE 85, 96–99 (OECD ed. 1997). Cf. Toshiaki Tachibanaki, *Surviving the Recession Without Slashing Payrolls*, 26 JAPAN ECHO No. 5, at 51 (Oct. 1999), at <http://www.japanecho.co.jp/docs/html/260517.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>139</sup> See Tachibanaki, *supra* note 138.

<sup>140</sup> Similarly, Fukao predicts the following realignment in various stakeholders' proportional claims to company assets:

- (1) Creditors > Core Employees > Top Executives > Shareholders (but only realized profits that could be used as dividends) > Other Employees; to
- (2) Creditors > Smaller Group of Core Employees > Top Executives > Shareholders (all profits, including unrealized profits) > Other Employees.

Fukao, *supra* note 71, at 21, 23.

By contrast, John Haley insisted recently that Japan will not change its fundamentally “communitarian” orientation without change in what he sees as the most distinctive and central institutional feature of post-war Japan: “entry level hiring coupled with a central personnel office staffed by senior career manager[s] with full responsibility for the recruitment, training, assignment and promotion of career staff”. See John O. Haley, *Japanese Law in Transition* n.19 (Apr. 6–7, 2000) (paper presented at the University of Michigan conference, “Change, Continuity, Context: Japanese Law in the Twenty-first Century”). As leading U.S. commercial law professor James White pointed out in oral response to Haley’s paper, this pattern has been pervasive among large companies in the United States (e.g., TWA and GM). Even more compellingly, Masako Kamiya responded that the pattern seen as central by Haley is irrelevant to the large majority of Japanese firms and employees (many still with only high school education). More generally, Haley’s paper did not provide any empirical data on labor market changes or perceptions, or legislative changes, as presented in Part IV of this article.

relationship).<sup>141</sup> This can simply be reversed to analyze implications for corporate governance. The problem then becomes how employees, as principals, constrain managers, as agents who may prefer to fritter away company funds on themselves. Again, one solution is to give employees shares in the company (through ESOPs and the like), but this will only restrict managers to the extent that agency problems between shareholders and managers are resolved generally.<sup>142</sup> Otherwise, the only realistic alternative is more control-oriented measures. One example is the two-tier board structure for German stock companies, in which a supervisory board is partly elected by employees, and then appoints management board members.<sup>143</sup> Japanese corporate law provides no such formal mechanism for employee supervision of managers. Yet control arises in practice especially because most managers in large Japanese companies have been appointed from among existing employees, in a system of life-long employment and promotion based primarily on seniority. Correspondingly, the external labor market has not grown much in recent decades.

Again, the origins of such institutions are unclear. Like several supposedly distinctive features of Japanese law (such as a limited number of practicing lawyers),<sup>144</sup> the practice of lifelong employment seems to have taken root only quite recently.<sup>145</sup> Ronald Gilson and Mark Roe observe that:

[F]rom World War I through the end of World War II, worker mobility in external labor markets eroded labor stability when labor was tight, and employers' willingness to fire even senior workers eroded labor stability when labor markets were not tight. Employers tried but failed to build wage and seniority

---

<sup>141</sup> Yamakawa, *supra* note 136.

<sup>142</sup> See *supra* Part II.

<sup>143</sup> See generally Mark Roe, *German Codetermination and German Securities Markets*, 5 COLUM. J. EUR. L. 199 (1999).

<sup>144</sup> Frank K. Upham, *Weak Legal Consciousness as Invented Tradition*, in MIRROR OF MODERNITY: INVENTED TRADITIONS OF MODERN JAPAN 48, 60-61 (Stephen Vlastos ed., 1998); John O. Haley, *The Myth of the Reluctant Litigant*, 4 J. JAPAN. STUDIES 359, 385 (1978).

<sup>145</sup> Cf. Daniel H. Foote, *Judicial Creation of Norms in Japanese Labor Law: Activism in the Service of Stability?*, 43 UCLA L. REV. 635, 651 (1996); Jackson, *supra* note 16.

structures to induce workers to stay during labor shortages. Government intervention reduced but failed to stop turnover.<sup>146</sup>

Gilson and Roe argue that lifetime employment practices arose in the even more unlikely economic environment shortly after World War II, characterized by extreme labor surplus, because of exceptional political events.<sup>147</sup> Rapid unionization and radical worker activism (strikes and plant takeovers) prompted conservative reactions and a "deal" establishing a privileged segment of labor (mainly surviving employees) accorded lifetime employment.<sup>148</sup> Thereafter, "Japan's economic problem was to craft associated institutions that could function effectively given the politically imposed lifetime employment," including restrictions in external labor markets.<sup>149</sup> Yet nowadays Japan faces a very different political as well as economic environment, with record unemployment (and further "under-employment"), and institutional changes opening up the possibility again of increasing worker mobility through external labor markets. Gilson and Roe also identify several significant "stress points" in the post-war Japanese system.<sup>150</sup> For instance, it does not cope well during times of dramatic technological change,<sup>151</sup> and "competition" among lifelong employees for promotion in an internal labor market will not work effectively when firms no longer are growing.

Rather similarly, Zenichi Shishido points out that labor turnover rates in the 1920s and 1930s were almost the same as those in the United States but the latter jumped in the 1940s and

---

<sup>146</sup> Ronald Gilson & Mark Roe, *Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance*, 99 COLUM. L. REV. 520 (1999).

<sup>147</sup> *Id.* at 520-24.

<sup>148</sup> *Id.* at 521-24.

<sup>149</sup> *Id.* at 524.

<sup>150</sup> *Id.* at 537-40.

<sup>151</sup> *Id.* at 538. This may be particularly problematic in view of significant developments in information technology in the late 1990s, after an admittedly slow start at least compared to the United States. Cf. generally Luke Nottage, *Cyberspace and the Future of Law, Legal Education and Practice*, WEB J. OF CURRENT LEGAL ISSUES (1998), at <http://webjcli.ncl.ac.uk/1998/issue5/nottage5.html> (on file with the North Carolina Journal of International Law and Commercial Regulation) (an updated version of this article will be available in TRANSNATIONAL CYBERSPACE LAW (Graham Greenleaf & Makoto Ibusuki eds., forthcoming)).



have remained much higher ever since.<sup>152</sup> He argues that the transformation in the United States was linked to the Great Depression, and that if the Japanese recession continues there will be an irreversible decline in lifetime employment as a key aspect sustaining the post-war corporate governance system in Japan.<sup>153</sup> More generally, ongoing recession creates a zero-sum situation and heightens conflicts between employees and other stakeholders, notably shareholders.<sup>154</sup> The latter will no longer tolerate employees being treated as de facto residual claimants, for instance earning wage hikes or salary bonuses while dividends remain constant or decline.<sup>155</sup> Shishido also identifies a parallel strengthening of the external labor market and the corporate control (share-)market.<sup>156</sup>

Labor law scholars such as Ryuichi Yamakawa, perhaps due to reliance on more historical data, are more impressed by the enduring quality of the post-war model, but note a number of major challenges to this model.<sup>157</sup> One is precisely the broader political economy environment.<sup>158</sup> The recession plus deregulation

---

<sup>152</sup> Shishido, *supra* note 55, at 222.

<sup>153</sup> *Id.*

<sup>154</sup> *Id.* at 216.

<sup>155</sup> *Id.* at 215. Hitherto uniform and almost ritualized, in Spring 2000 collective wage bargaining was distinguished by no major wage increases, even in the largest firms. 2000 Spring Offensive: Signs of Change, 39 JAPAN LAB. L. BULL. No. 6 (2000), at <http://www.jil.go.jp/bulletin/year/2000/vol39-06/02.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation). Further:

A Ministry of Labour survey suggests it is likely that the average pay hike in percentage terms will be around two percent, lower than the previous record low of 2.21 percent last year. Many labor leaders believe that the outcome of this year's wage talks reflects an on-going shift in the priority which management is now giving to shareholders at the expense of employees, a situation they view with alarm.

*Id.* The merger of new industry-based unions, and the creation of some totally new ones, may also be important in that respect. See, e.g., *Reshuffling of Industry-Based Unions*, 39 JAPAN LAB. L. BULL. No. 1 (2000), at <http://www.jil.go.jp/bulletin/year/2000/vol39-01/04.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation); cf. generally Mari Sako, What is the Boundary of the Firm for Enterprise Unions in Japan? (June 10–11, 1999) (paper presented at the EUI Conference, “The Political Economy of Corporate Governance in Europe and Japan”).

<sup>156</sup> Shishido, *supra* note 55, at 217.

<sup>157</sup> Yamakawa, *supra* note 136.

<sup>158</sup> *Id.*

creates more variability in corporate profitability, a key factor as the credit crunch still facing Japanese financial institutions further encourages companies to turn to stock and bond markets—often global, and more demanding of good corporate/managerial performance. In addition, the service sector continues to grow in importance, bringing the need for (and the possibility of) more flexible working hours.<sup>159</sup> Both factors are related to changing demographics in the labor force generally, characterized by more elderly people, women, and part-time workers.<sup>160</sup> This also affects the resilience of lifelong employment as a core concept in the Japanese corporate world. Yamakawa still concludes that it will remain, albeit with some modifications.<sup>161</sup> In particular, he relies on a 1999 survey of the Japanese Institute of Labor in which 33.8% of respondents (690 companies out of 2370 employing 1000 or more people) declared that they intended to maintain the life-long employment system; 44.8% said it had to be partially modified; and 17.1% said it needed radical reexamination.<sup>162</sup>

Fujikazu Suzuki suggests that “some persistence of the long-term employment practice” is indicated by a survey conducted in February 1999, by the Research Institute for the Advancement of Living Standards, a think tank funded by the Japanese Trade Union Confederation (*Rengo*).<sup>163</sup> Senior managers from 731 out of 1307 companies listed on the first section of the Tokyo Stock Exchange mostly thought that it was “not probable” over the next five years that “employees with short length of service become ordinary even in the core members” (59.4%); only 11.56% thought it “probable,” with 27.1% unable to guess and 0.8% reporting it

---

<sup>159</sup> Cf. Tadashi Hanami, *Japan*, in NON-STANDARD WORK AND INDUSTRIAL RELATIONS 209 (Roger Blanpain et al. eds., 1999).

<sup>160</sup> Katsutoshi Kezuka, *Legal Problems Concerning Part-Time Work in Japan*, 39 JAPAN LAB. L. BULL. No. 9 (2000), at <http://www.jil.go.jp/bulletin/year/2000/vol39-09/06.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>161</sup> Ryuichi Yamakawa, *Labor and Law Reform in Japan: A Response to Recent Socio-Economic Changes*, Presentation at the Fourth Sho Sato Conference, “Legal Reform and Social Change in Japan,” 3 (Nov. 4–5, 1999) (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>162</sup> *Id.*

<sup>163</sup> Fujikazu Suzuki, *How the Top Managers See the Japanese Corporation* (June 10–11, 1999) (paper presented at the EUI Conference, “The Political Economy of Corporate Governance in Europe and Japan”).

“happening now.”<sup>164</sup> However, a similar majority (56.6%) thought it probable that promotion would come to be based on performance rather than seniority, a trend also acknowledged by Yamakawa.<sup>165</sup> The *Rengo* survey also shows that most managers tended to expect significant changes in manager attention to Return on Shareholder Equity and management monitoring mechanisms.<sup>166</sup>

Further pressures on the lifelong employment system are provided by a survey by a Labor Ministry working group in January 2000.<sup>167</sup> It found that only 9.5% of 591 respondent firms continued attaching importance to life long employment, while 38.3% did not and 51% did so only on a limited basis.<sup>168</sup> However, a problem with all these surveys is that they question incumbents within firms. To get a better picture of the future of this central aspect of Japan’s employment and corporate governance systems, more research should be conducted into what young people want nowadays. Certainly it seems that they are disillusioned with the fact that present employment patterns in Japan are strongly biased towards the incumbent, older generation, especially those in lifelong employment.<sup>169</sup>

Finally, Yamakawa reviewed the major changes recently made to an array of labor legislation.<sup>170</sup> These should prompt—or at least cement in place—broader transformations in the labor market in Japan.<sup>171</sup> The main changes can be summarized as follows:<sup>172</sup>

---

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> *More Japanese Firms See Life Employment Unnecessary: Survey*, JAPAN WKLY. MONITOR, Nov. 20, 2000, 2000 WL 30239779.

<sup>169</sup> See generally Yuji Genda, *Youth Employment and Parasite Singles*, 39 JAPAN LAB. L. BULL. No. 3 (1999) (arguing that the younger generation’s relatively high unemployment is more the result of a shrinking demand for labor than due to a perceived generational lack of work ethic and drive), at <http://www.jil.go.jp/bulletin/year/2000/vol39-03/05.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>170</sup> Yamakawa, *supra* note 161, at 1–2, 5–14.

<sup>171</sup> This assumes that formal legal rules do matter in Japan. By contrast, Anna Maria Konsta concludes to the contrary, focusing on labor law generally and working time regulation in particular. Anna Maria Konsta, *Working Time Law in Japan and the European Union: A Comparative Approach in the Context of Legal Culture* (2000)

- 1998 amendments to the Labor Standards Law: allowing longer-term labor contracts, requiring written clarifications of work conditions upon hire and reasons for termination (a growing source of tension),<sup>173</sup> and divorcing overtime

---

(unpublished Ph.D. thesis, European University Institute, Florence), at <http://biblio.iue.it/search/akonsta/1,6,7,B/frameset&F=aknosta+anna+maria&1,1> (on file with the North Carolina Journal of International Law and Commercial Regulation). This runs directly contrary to the analyses of Daniel Foote, a well-known commentator in this and other areas of Japanese labor law. See, e.g., Daniel H. Foote, *Law as an Agent of Change? Governmental Efforts to Reduce Working Hours in Japan*, in JAPAN: ECONOMIC SUCCESS AND LEGAL SYSTEM 251 (Harald Baum ed., 1997); Daniel H. Foote, *Resolution of Traffic Accident Disputes and Judicial Activism in Japan*, 25 LAW IN JAPAN 19 (1995). The notion that law does not matter in Japan is also gainsaid by sociologically informed studies of product liability, contracting, and commercial arbitration. See, e.g., Luke Nottage, *The Present and Future of Product Liability Dispute Resolution in Japan*, 27 WM. MITCHELL L. REV. 215 (2000); Luke Nottage, *Economic Dislocation and Contract Renegotiation in New Zealand and Japan: A Preliminary Empirical Study*, 27 VICT. U. L. REV. 59 (1997); Luke Nottage, *Planning and Renegotiating Long-Term Contracts in New Zealand and Japan: An Interim Report on an Empirical Research Project*, N.Z. L. REV. 482 (1997); Luke Nottage, *The Vicissitudes of Transnational Commercial Arbitration and the Lex Mercatoria: A View from the Periphery*, 16 ARB. INT'L No. 1, at 53 (2000) (on file with the North Carolina Journal of International Law and Commercial Regulation). Even the mainstream media appears to have abandoned the strongly "culturalist" explanation of Japanese law which guides Konsta's thesis. Tim Larimer, *Targeting Japan Inc.*, TIME ASIA, Sept. 25, 2000, <http://www.time.com/time/asia/magazine/2000/0925/japan.consumers.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>172</sup> Luke Nottage, *Japan*, in *Doing Business in Asia* (CCH) paras. JPN ¶ 60-003 ff.

<sup>173</sup> Since coming into effect in October 1998, a scheme involving informal and formal conciliation by Ministry of Labor officials in individual employment disputes has been used increasingly, with dismissals being the major category of dispute. These processes rely on voluntary settlement brokered by government officials, but labor interests now propose that the Labor Relations Commission be allowed to rule on the full range of individual labor disputes. See, e.g., *The Dispute Resolution Support System*, 39 JAPAN LAB. L. BULL. No. 10 (2000), at <http://www.jil.go.jp/bulletin/year/2000/vol39-10/05.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation). Underpinning this development is an escalating number of disputes brought before District Courts. The annual number of lawsuits concerning individual labor disputes has tripled over the last decade, exceeding 2000 cases in 2001. See Trends in the Number of Lawsuits Involving Labor Disputes 1989-2000, 40 JAPAN LAB. L. BULL. No. 6 (2001), at <http://www.jil.go.jp/bulletin/year/2001/vol40-06/07.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation). Cf. generally, Nottage, *supra* note 172, para. JPN ¶ 60-011.

Meanwhile, amendments to Japan's unemployment benefit scheme (in effect from April 2001) have reduced payouts to those in their early sixties, and increased those to younger workers. See, e.g., *Revision of the Employment Insurance Law*, 39 JAPAN LAB.

payments from hours worked (indicating more stress on quality of work);

- 1997 amendments to the Equal Employment Opportunity Law:<sup>174</sup> now prohibiting discrimination in recruitment, assignment, and promotion, as well as in dismissal and retirement, compelling employers to mediation if requested by employees, and addressing problems of sexual harassment (still a frequent source of litigation, since the early 1990s);<sup>175</sup>
- 1995 amendments (in effect from April 1999) to the Child Care Law: extending leave to provide care to elderly family members;<sup>176</sup>
- 1999 amendments to the Working Dispatching Law: abolishing the “positive list” system of limiting dispatching to specified (professional) job categories, in favor of a “negative list” system, and putting pressure on companies

---

L. BULL. No. 7 (2000), at <http://www.jil.go.jp/bulletin/year/2000/vol39-07/05.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>174</sup> Cf. Tadashi Hanami, *Equal Employment Revisited*, 39 JAPAN LAB. L. BULL. No. 1 (1999) (noting that the 1997 Amendment of the Equal Employment Opportunity Law introduced for the first time official endorsement of positive anti-discrimination measures by employers and regulations dealing with sexual harassment), at <http://www.jil.go.jp/bulletin/year/2000/vol39-01/05.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>175</sup> Indeed, the first case of sexual harassment of a male has recently attracted public attention. See, e.g., *Fukuoka Man Settles Sexual Harassment Case with Male Boss*, JAPAN WKLY. MONITOR, Jan. 22, 2001, 2001 WL 9082331. More generally, on the responses to heightened awareness of this issue due to litigation and legislative amendments, see *Sexual Harassment: Actual Inquiries and the Responses of Companies*, 39 JAPAN LAB. L. BULL. No. 7 (2000), at <http://www.jil.go.jp/bulletin/year/2000/vol39-07/02.htm#1> (on file with the North Carolina Journal of International Law and Commercial Regulation); and Nottage, *supra* note 172, para. JPN ¶ 60-004. See also warnings published by the Ministry of Labor in June 2000. *Matters for Special Attention in Hiring Employees by Status*, 39 JAPAN LAB. L. BULL. No. 9 (2000), at <http://www.jil.go.jp/bulletin/year/2000/vol39-09/05.htm#1> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>176</sup> Further amendments, to be submitted to the Diet in 2001 to take effect beginning April 2002, will extend the availability of flex-time work schedules, shorter working hours or exemptions from overtime work, to care for children until they turn three (rather than one). See Mainichi Shimbun, *Work and Family*, MAINICHI DAILY NEWS, Dec. 29, 2000, <http://mdn.mainichi.co.jp/news/archive/200012/29/20001229p2a00m0a098000c.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

using such temporary helpers to offer them employment first if the company decides to hire for work done by the temporary helpers (potentially creating a new hybrid category of employees);<sup>177</sup>

- Simultaneous amendments to the Employment Security Law: also changing to a “negative list” system for private placement of non-temporary workers, clearer licensing for businesses doing this, and replacement of a blanket fee maximum chargeable (which hampered attempts to head-hunt and place managers);<sup>178</sup>

---

<sup>177</sup> See generally Takashi Araki, *1999 Revisions of Employment Security Law and Worker Dispatching Law*, 38 JAPAN LAB. L. BULL. No. 9 (1999) (noting that the 1999 revisions of the Working Dispatch Law has drastically relaxed regulations of worker dispatching businesses by simplifying administrative procedures while at the same time strengthening dispatch worker protection), at <http://www.jil.go.jp/bulletin/year/1999/vol38-09/06.htm> (on file with the North Carolina Journal International Law and Commercial Regulation).

<sup>178</sup> See generally *id.* (noting that the revision of the Employment Security Law of 1947 has lifted the general prohibition on private fee-charging placement businesses and has placed private placement services as a coexisting player with public placement services engaging in the supply-and-demand adjustment of the Japanese labor market). Further:

According to the Ministry of Labor, from December 1, 1999 (when the laws came into effect) to June 1, 2000, 293 enterprises offered fee-charging job placement services (an increase of 34 percent compared to the same period in the previous year) and 898 enterprises were dispatching employees to other firms (an increase of 23 percent). As of June 1, 2000, the number of private fee-charging job placement businesses totaled 3,930, an increase of 8.1 percent from the end of November 1999 . . . . According to the Special Survey of the Labor Force Survey conducted in February [2000] by the Management and Coordination Agency, only 2.8 percent of unemployed people rely on private job placement agencies when looking for work. That compares with 40.1 percent who rely on Public Employment Security Offices. On the other hand, some 900,000 workers were dispatched in fiscal 1998, 4.7 percent more than the previous year. Thus, although the private sector still plays a minor role in the market, as employment patterns become more varied in the future, rapid expansion of private job placement firms is expected. Moreover, since workers can now be dispatched to any category of job, it is almost certain that their numbers and significance will increase in the near future.

*Participation in Private Employment Placement Services Increases*, 39 JAPAN LAB. L. BULL. No. 9 (2000), at <http://www.jil.go.jp/bulletin/year/2000/vol39-09/02.htm#1> (on file with the North Carolina Journal of International Law and Commercial Regulation). See, e.g., *2000 Economic Survey of Japan: A New Era Begins*, 39 JAPAN LAB. L. BULL. No. 10 (2000) (noting that the number of employees in managerial posts has fallen while dispatched workers are in increasing demand), at <http://www.jil.go.jp/bulletin/year/2000/>

- 1999 enactment of a Fundamental Law for a Gender-Equal Society (which may encourage affirmative action programs, etc.);<sup>179</sup>
- Moves to promote pension plans based on “defined contributions” pension, rather than just “defined benefits” (which had discouraged voluntary job-switching, because complete vesting was unusual);<sup>180</sup> and
- Draft legislation announced in mid-2001 to promote reemployment, prompted by record levels of unemployment.<sup>181</sup>

In addition to recent changes in the legal environment, long-standing transformations in the political economy are broadly related to globalization.<sup>182</sup> Globalization is also beginning to have a more direct effect on the Japanese labor market. In the boom times of the 1980s, many “guest workers” were brought in for blue-collar work, which the Japanese were unwilling to touch. Many have stayed on, often illegally. Yet a significant feature of

---

vol39-10/01.htm (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>179</sup> Nottage, *supra* note 172, para. JPN ¶ 60-034. Cf. *Fundamental Law for a Gender-Equal Society*, 38 JAPAN LAB. L. BULL. No. 9 (1999) (noting that the Fundamental Law for a Gender-Equal Society obliges the government to establish a basic plan for a gender-equal society and a procedure for handling complaints concerning its measures), at <http://www.jil.go.jp/bulletin/year/1999/vol38-09/05.htm#1> (on file with the North Carolina Journal of International Law and Commercial Regulation); *White Paper on Gender Inequality*, 39 JAPAN LAB. L. BULL. No. 8 (2000) (noting that this paper is the first report promulgated under the mandate put forth by the Basic Law for a Gender-Equal Society), at <http://www.jil.go.jp/bulletin/year/2000/vol39-08/01.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>180</sup> Japan Econ. Newswire, *Cabinet OKs Bill for New Defined-Benefit Pension Plans*, Feb. 20, 2001. Although the proposed reforms only address hybrid schemes, even the largest Japanese companies have already begun voluntarily recrafting their pension schemes to allow more transportability. In 1999, for instance, Matsushita Electric Industrial Company allowed the option of taking “retirement benefits in twice-yearly increments while still on the job, rather than in a lump sum at retirement . . . . More than 40% of new hires have chosen the incremental payments, four times the number Matsushita expected.” Yumiko Ono & Bill Spindle, *Japan's Decline Makes One Thing Rise: Individualism Soured on Consensus*, ASIAN WALL ST. J., Jan. 3, 2001, at 1.

<sup>181</sup> *Draft of Law to Facilitate Reemployment*, 40 JAPAN LAB. L. BULL. No. 5 (May 1, 2001), at <http://www.jil.go.jp/bulletin/year/2001/vol40-05/04.htm#1> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>182</sup> See *supra* notes 147–69 and accompanying text.

the 1990s was a slowly growing presence of white-collar employees and managers from abroad, even at the senior executive level.<sup>183</sup> This is most noticeable in the financial sector, but it is tied to broader patterns in foreign direct investment, especially mergers and acquisitions involving companies from abroad.<sup>184</sup> While it is too early to say what independent effect these developments will have on the labor market in Japan, cumulatively they reinforce the changes impacting the future of corporate governance in Japan.<sup>185</sup>

## V. Conflicting Tendencies in Industrial Production and the State

Applying principal-agent theory to analyze three key aspects of Japanese corporate governance suggests that the interests of managers and shareholders have drawn closer together and that severe challenges have emerged for corporate finance centered on main banks. However, pressures reshaping employment relations may be less obvious and may consolidate only over the long term. Overall, these transformations amount to more convergence on the arm's length relations characteristic of Anglo-American corporate governance. Further complicating the picture, however, the notion of opportunism underlying principal-agent theory may not be the only force at work. This becomes apparent when further stakeholders in the firm are brought into view.

Another important set of stakeholders, affecting the relations among the others described so far, consists of the firm's outside suppliers and customers. Particularly intriguing are the cooperative relations which have developed among firms,

---

<sup>183</sup> *Non-Japanese Employees in Japan: Report of the Ministry of Labour*, 40 JAPAN LAB. L. BULL. No. 3 (Mar. 1, 2001), at <http://www.jil.go.jp/bulletin/year/2001/vol40-03/03.htm#1> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>184</sup> See, e.g., Bonacker, *supra* note 92. See also Sibbitt, *supra* note 109.

<sup>185</sup> By the end of 1998, despite the recession, the number of registered foreign workers had increased a further 2% to reach a record high. *Registered Foreigners Exceed 1.5 Million*, 38 JAPAN LAB. L. BULL. No. 9 (Sept. 1, 2001), at <http://www.jil.go.jp/bulletin/year/1999/vol38-09/02.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation). See also Gregory Clark, *Why is Japan Turning to Foreigners for Help?*, 27 JAPAN ECHO No. 2 at 41 (2000), available at <http://www.japanecho.co.jp/docs/html/270212.htm> (on file with the North Carolina Journal of International Law and Commercial Regulation).



especially in the automobile industry, notably in post-war Japan but later finding root in the United States. Recent studies of industrial organizations have focused on “learning by monitoring” in the automobile industry (and some others), involving: (1) benchmarking (exacting surveys of current, and likely future, products and processes) to uncover new general processes; (2) simultaneous engineering (where subunits responsible for components undertake similar benchmarking, while considering implications for other subunits, which may lead to redefining the project as a whole); and (3) systems of strict error detection and correction for the new routines, with further extensive information sharing to respond quickly before consequences become disastrous.<sup>186</sup> The emergence of this paradigm suggests that pervasive patterns of information sharing may entrench norms of cooperation, seen not just as a means of securing individual benefits but rather as ends in themselves, underpinned by a vision of “enlarging the pie” rather than trying to obtain a larger slice at the others’ expense. History also shows how dramatic changes in conditions may unravel such collaborative relations (as in the U.S. automobile industry over the 1960s and 1970s) but then builds them up again as underlying mechanisms become apparent (as in the 1980s and 1990s).<sup>187</sup>

Little comprehensive data is readily available on what has happened to relations among firms in Japan’s automobile industry, especially in the late 1990s,<sup>188</sup> when the changes to other aspects of corporate governance appeared to find more traction. Despite some notable developments,<sup>189</sup> the economic and sociologic

---

<sup>186</sup> Helper et al., *supra* note 42, at 445–46.

<sup>187</sup> *Id.* at 475–76.

<sup>188</sup> Historical data is not presented, for example, in Yoshiro Miwa & J. Mark Ramseyer, *Rethinking Relationship-Specific Investments: Subcontracting in the Japanese Automobile Industry*, 98 MICH. L. REV. 2636 (2000).

<sup>189</sup> Japanese automobile makers contracted with 1,245 companies in 1994, compared to 298 in 1987, and bought \$15.5 billion in parts from the United States in 1993, six times more than in 1986. See Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of All Worlds*, 3 VAND. J. TRANSNAT’L L. 829, 848 (2000). See also Mitsuo Ishida, *Japan: Beyond the Model for Lean Production*, in AFTER LEAN PRODUCTION: EVOLVING EMPLOYMENT PRACTICES IN THE WORLD AUTO INDUSTRY 45 (Thomas A. Kochan et al. eds., 1997); see discussion *supra* note 93 (broader restructuring in the wake of Renault’s investment in Nissan). Parts are increasingly procured from operations around the world, and almost

underpinnings of cooperative inter-firm relations may prove resistant in this industry. It is demonstrably more successful, and still holds reserves to draw on, compared for instance to Japan's weak financial sector. Further, Noboru Kashiwagi reports that although Japan's auto manufacturers are now using e-commerce to unwind *keiretsu* or preferential relationships with suppliers for standardized products, they are retaining such relationships for more technologically complex parts.<sup>190</sup> Relative stasis in such an important production chain would present a tension with the trends towards change identified above,<sup>191</sup> even if the latter relations (within the firm) are more constitutive of corporate governance. But a similar tension arguably characterized the United States over the 1980s and 1990s, as contracting among firms (at least in some manufacturing and services sectors) became based more on information sharing and learning by monitoring, yet arm's length control and market-based coordination increasingly characterized corporate governance in its narrower sense.<sup>192</sup>

The entrenchment of learning by monitoring mechanisms in the United States at the level of industrial production, and their possible resilience in Japan,<sup>193</sup> may encourage the emergence of

---

all Japanese automobile manufacturers have seen significant foreign investment since 1996. See, e.g., METI, at <http://www.meti.go.jp/english>.

<sup>190</sup> Noboru Kashiwagi, *I Can't Turn You Loose: The Termination of Distributors and Agents in Japan* at Parts 2 and 3.b.v. (Apr. 6–7, 2001) (paper presented at the University of Michigan Conference, "Change, Continuity, Context: Japanese Law in the Twenty-First Century"). See also Scott E. Masten, *Reaffirming Relationship-Specific Investments: Comments on Miwa and Ramseyer's 'Rethinking Relationship-Specific Investments'*, 98 MICH. L. REV. 2668, 2674 (2000).

<sup>191</sup> Kashiwagi, *supra* note 190.

<sup>192</sup> Charles F. Sabel, *Design Deliberation and Democracy: On the New Pragmatism of Firms and Public Institutions* (Dec. 15–16, 1995) (paper presented at the EUI Conference, "Liberal Institutions, Economic Constitutional Rights, and the Role of Organizations") at <http://www.law.columbia.edu/sabel/papers/Design.html> (on file with the North Carolina Journal of International Law and Commercial Regulation). Charles F. Sabel, *Ungoverned Production: An American View of the Novel Universalism of Japanese Production Methods and their Awkward Fit with Current Forms of Corporate Governance* (Feb. 16, 1996) (paper presented at the Institute of Fiscal and Monetary Policy Conference, "Socio-economic Systems for the 21st Century"), at <http://www.law.columbia.edu/sabel/papers/Japan.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>193</sup> For an interesting experiment in a different sector, see *IBM Japan Knits Parts Suppliers into Chain: On-Site Storage of Modules Cuts Response Time, Costs*, NIKKEI WKLY, Feb. 12, 2001, at 10. See generally Helper et al., *supra* note 42, at 479–80.

novel forms of corporate governance in both countries. They might include “corporate incubators” for strategic thinking established within firms, performance metrics based on baskets of measures subjected to continuous review and redefinition, and venture capitalists. However, these applications are less well established than in industrial production, and are thought to run more risk of being displaced by more straightforward market-based corporate governance mechanisms.<sup>194</sup>

On the other hand, similar processes of learning may also support novel forms of corporate governance by monitoring at the level of the state—a further, broader stakeholder in corporate organization. An important parallel trend in advanced industrialized democracies appears to be “democratic experimentalism,”<sup>195</sup> involving: (1) central authorities which “create a framework for experimentation by defining broad problems, setting provisional standards, pooling measurements of local performance, aiding poor performers to correct their problems, and revising standards and overall goals according to results”; and (2) “local units” doing most of the problem-solving but which are “accountable to the center, and to their local constituents, who participate in formulating its plans, and judge it both against those goals and in comparison to the performance of other locales in like circumstances.”<sup>196</sup> Key parameters in experimentation involving the state are, again, transparency and participation by diverse affected actors to prompt access to—and effective use of—information, with the objective of developing collaborative and effective relations.

Important trends in this direction in Japan nowadays include sweeping deregulation programs, although these have tended to get bogged down in detail and bureaucracy;<sup>197</sup> enactment of

---

<sup>194</sup> Helper et al., *supra* note 42, at 477–81.

<sup>195</sup> Michael Dorf & Charles Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267 (1998).

<sup>196</sup> Charles Sabel & Rory O'Donnell, *Democratic Experimentalism: What To Do About Wicked Problems after Whitehall (and What Scotland May Just Possibly Already be Doing)* Part 6 (Feb. 28–29, 2000) (paper presented at the OECD Conference on “Devolution and Globalization: Implications for Local Decision-Makers”), at <http://www.law.columbia.edu/sabel/papers/glasPO.html> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>197</sup> Akira Kawamoto, *Unblocking Japanese Reform*, 216 OECD OBSERVER, Mar.

nationwide official information disclosure legislation;<sup>198</sup> comprehensive proposals in mid-2001 for reform of the entire system for administering justice in Japan;<sup>199</sup> more engagement with foreigners and foreign models, although still often too reactive and lacking in vision;<sup>200</sup> some legal recognition of previously marginalized ethnic groups;<sup>201</sup> and adroit attempts by other minorities to avoid “bureaucratic capture” while improving their lot.<sup>202</sup> To be sure, steps may have been more faltering than in some neighboring countries, like Korea.<sup>203</sup> Yet significant momentum has been generated in Japan over the last decade, pointing the way towards more sustained polyarchic “deliberative democracy.”<sup>204</sup> This adds further contingencies, and difficulties in assessing existing and potential changes in Japanese corporate governance. But these more political dimensions may prove to be the most crucial, despite having been overlooked by most commentators, especially those writing for law reviews, in the debate so far.<sup>205</sup> The seeming paralysis of Japanese policy-makers

---

1999, at 5, available at <http://www.oecdobserver.org/news/fullstory.php?aid=5> (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>198</sup> Narufumi Kadomatsu, *The New Administrative Information Disclosure Law in Japan*, 8 ZEITSCHRIFT FUER JAPANISCHES RECHT 34 (1999), available at <http://www.djjv.org/japrecht/heft8/abhandlungen/kadomatsu.html>.

<sup>199</sup> Tom Ginsburg, Luke Nottage & Hiroo Sono, *The Worlds, Vicissitudes, and Futures of Japan's Law*, in THE MULTIPLE WORLDS OF JAPANESE LAW: DISJUNCTIONS AND CONJUNCTIONS 1, 13 (Tom Ginsburg, Luke Nottage & Hiroo Sono, eds., 2001).

<sup>200</sup> Clark, *supra* note 185.

<sup>201</sup> Mark A. Levin, *Essential Commodities and Racial Justice: Using Constitutional Protection of Japan's Indigenous Ainu People to Inform Understandings of the U.S. and Japan*, 33 N.Y.U. J. INT'L L. & POL. 419, 423 (2001).

<sup>202</sup> Karen Nakamura, *Manipulating the System from Within: Deaf Civil Society Organisations in Japan* (Apr. 6–7, 2001) (paper presented at the University of Michigan Conference, “Change Continuity and Context: Japanese Law in the Twenty-First Century”) (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>203</sup> Tom Ginsburg, *Dismantling the Developmental State? Administrative Procedure Reform in Japan and Korea*, 49 AM. J. COMP. L. (forthcoming).

<sup>204</sup> Cf. generally Joshua Cohen & Charles Sabel, *Directly Deliberative Polyarchy*, 5 EUR. L. J. 313 (1997), available at <http://www.law.columbia.edu/sabel/papers/DDP.html> (on file with the North Carolina Journal of International Law and Commercial Regulation) (defending directly-deliberative polyarchy as a viable alternative to current governance structures).

<sup>205</sup> Recently, however, Fort and Schipani have advocated various corporate

over the last decade, despite the welter of woeful economic news described in the opening quote in this paper,<sup>206</sup> can then be seen in a more positive light. Perhaps it shows important elements of “democratic experimentalism,” with (1) central authorities slowly reassessing key building blocks after extensive analysis of world-wide trends, but (2) leaving it primarily to social-economic sub-units (such as major stakeholders in firms, including creditors and employees, with their peak associations) to find a new balance and form of governance combining efficiency with normative acceptability.<sup>207</sup> However, such a positive assessment turns

---

governance mechanisms based rather similarly on the firm as “mediating institution,” premised on empowerment and “participants within the organization [having] the requisite voice and power to have economic and non-economic concerns expressed and integrated into their business communities.” Fort & Schipani, *supra* note 189, at 865. Cf. Leon Wolff, *Private Governance of Public Rights in Japan: Revisiting the Japanese Governance Debate*, 302 PAC. ECON. PAPERS 3.21–3.23 (2000) (discussing the problems that may arise when policymaking and regulations are left to corporations).

Ballon and Honda argue that “the challenge of business lies in fostering the *capacity to learn* and the *willingness to learn*, namely, to learn from other stakeholders about the vagaries of the market, of technology, of administration, and so on, and to learn how to overcome the steady obsolescence of skills and physical assets.” BALLON & HONDA, *supra* note 31, at xviii (emphasis in original). But their later discussion of the “national context,” especially of allegedly pervasive “government paternalism,” follows conventional wisdom in depicting a system that generates considerable information, but through more hierarchical methods involving considerable exclusion of potential participants. *Id.* at 74–79.

Finally, Mark Roe has long argued in general terms for the importance of path dependency in the national evolution (or otherwise) of corporate governance regimes, and has recently applied these insights to analyze lifelong employment in Japan. See Mark J. Roe, *Path Dependence, Political Options and Governance Systems*, in COMPARATIVE CORPORATE GOVERNANCE 165 (Klaus J. Hopt & Eddy Wymeersch eds., 1997); Gilson & Roe, *supra* note 146, at 517–18. However, although the starting point in this analysis is political contingency (like the deal reached between managers and/or politicians and a segment of the labor force soon after World War II in Japan), the system is then reproduced and perhaps—but often not—changed following cost-benefit assessments by actors in the circumstances. The approach is therefore primarily a “utilitarian” variant of path dependence theory. Cf. James Mahoney, *Path Dependence*, 29 THEORY AND SOC’Y 507, 517 (2000) (pointing out a number of other variants). Sabel’s approach, and hence that presented in Part V of this article, implies elements also of a “legitimation” variant of path dependency, whereby the “institution is reproduced because actors believe it is morally just or appropriate,” and is then transformed due to “changes in the values or subjective beliefs of actors.” See Sabel, *supra* note 192.

<sup>206</sup> See *supra* note 1 and accompanying text.

<sup>207</sup> Cf., e.g., MARK WEST, THE PUZZLING DIVERGENCE OF CORPORATE LAW: EVIDENCE AND EXPLANATIONS FROM JAPAN AND THE UNITED STATES 31–34, 62 (John M.

crucially on whether the Japanese state is—and will remain—committed to fostering information flows and decentralized participation in decision-making among diverse socio-economic groups.

## VI. Conclusions

Overall, the combination of globalization, deregulation, and recession in Japan throughout the 1990s has generated more systematic change than predicted or implied by many proponents of “varieties of capitalism” theory.<sup>208</sup> To monitor relations in central areas of corporate governance straddling key factors of production in contemporary economies, such as employees and suppliers of equity or debt capital, there have been important shifts towards more arm’s length or shareholder-based control-oriented strategies. These have occurred primarily in practices and expectations, but also (perhaps increasingly) in legislative rules.<sup>209</sup>

---

Olin Center for Law and Economics, Working Paper No. 00-011), at <http://papers.ssrn.com>, reprinted in 150 U. PENN. L. REV. (forthcoming 2002)) (discussing the role of advisory committees in the development of policy) (on file with the North Carolina Journal of International Law and Commercial Regulation).

<sup>208</sup> See *supra* Part I.

<sup>209</sup> See Milhaupt, *supra* note 86, at 16 (“The experience of the past decade . . . strongly indicates that Japanese corporate actors respond rapidly and voraciously to legal reform . . .”). Focusing elsewhere on social norms, Milhaupt concludes that there are other major transformations underway in business and government which are pushing Japan towards a shareholder-centered ideology:

Increased acceptance of the takeover as a legitimate tool of corporate strategy and monitoring (and a concomitant reduction of legal and structural impediments to M&A), a heightened awareness of shareholders’ economic expectations, a change in managerial mindset about its proper role in running the firm, diminished social expectations of forbearance on the part of banks and their regulators, and rising ambivalence about the benefits of seniority-based employment practices. These shifts are palpable and important. Taken together with the emerging evidence of parallel norm shifts underway in Europe, they portend a much narrower ideological spectrum on how and for whose benefits firms should be managed.

Milhaupt, *supra* 58, at 2125–26.

However, he adds: “the rapidity and extent of Japanese normative convergence towards the Anglo-American model should not be overstated. While signs of norm shifts are very recent, evidence of the inefficiency of the old norm structure surfaced nearly a decade ago. And signs of norm stickiness are abundant.” *Id.* Milhaupt also observes that changes in corporate law appear to have lagged behind significant changes in norms, such as new board structures. *Id.* at 2127. Yet he notes that such changes have recently

Yet the transformations are most pronounced in the stakeholder relationships among managers and employees,<sup>210</sup> and perhaps creditors,<sup>211</sup> and less obvious—but still significant—in labor markets.<sup>212</sup> Further, a rather different set of norms and arrangements may continue to characterize some important sectors of industrial production. Driven by information-sharing to develop and maintain trust, this may also reflect and support more participatory “democratic experimentalism” in the Japanese state.<sup>213</sup> Such conflicting tendencies at different levels further undermine influential theories of “varieties of capitalism,” which tend to see high degrees of internal consistency within such systems of economic and political ordering. They also raise doubts about the suggestion that “high trust” varieties (such as Germany’s system of capitalist organization, but perhaps also Japan’s) may disintegrate into “low-trust” or market-based varieties (arguably, the Anglo-American model), but not vice versa.<sup>214</sup> Finally, because democratic experimentalism is common to the United States and Britain as well, a deeper level of convergence appears to be emerging in Japan. But how various experiments play out in these countries, especially in reorienting Japanese corporate governance in its broadest sense, could well differ, leaving some important divergences.

---

been mooted. Viewing corporate governance more broadly, moreover, the legislative changes affecting labor relations have come remarkably quickly.

Finally, even when focusing on the development of corporate law rules, West may be overstating divergence in post-war Japan and the United States by focusing on (declining) numbers of “functionally similar” common rules. West, *supra* note 207, at 21–29. Although he does attempt to break down this quantitative analysis by dividing them into mandatory versus enabling rules, a more qualitative judgment as to which of these rules are more important seems essential to judge overall divergence versus convergence. *Id.* Also important is the starting point: the big shift (convergence) to more shareholder-oriented rules soon after World War II. Subsequent divergence from this new base-line may be decidedly less important in practical terms.

<sup>210</sup> See *supra* Part II.

<sup>211</sup> See *supra* Part III.

<sup>212</sup> See *supra* Part IV.

<sup>213</sup> See *supra* Part IV.

<sup>214</sup> Hall & Soskice, *supra* note 9.

